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# Senate Hearings

*Before the Committee on Appropriations*

COMPLETED
ORIGINAL

# Management of HUD's Multi-Family Properties— The Clifton Terrace Case

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*Fiscal Year* 1980

96th CONGRESS, FIRST SESSION

**SPECIAL HEARING**

**Department of Housing and Urban Development**
**General Accounting Office**
**Nondepartmental Witnesses**

best copy available

# MANAGEMENT OF HUD's MULTI-FAMILY PROPERTIES THE CLIFTON TERRACE CASE

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HEARINGS
BEFORE A
SUBCOMMITTEE OF THE
COMMITTEE ON APPROPRIATIONS
UNITED STATES SENATE
NINETY-SIXTH CONGRESS
FIRST SESSION

Printed for the use of the Committee on Appropriations

## SPECIAL HEARING

**Department of Housing and Urban Development**
**General Accounting Office**
**Nondepartmental Witnesses**

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# CONTENTS

---

TUESDAY, NOVEMBER 13, 1979

Page
Nondepartmental witnesses ..... 1 1/A5
General Accounting Office ..... 15 1/B5
Department of Housing and Urban Development ..... 29 1/C5
Nondepartmental witnesses ..... 33 1/C9

WEDNESDAY, DECEMBER 5, 1979

Department of Housing and Urban Development ..... 43 1/D5

WEDNESDAY, JANUARY 23, 1980

Nondepartmental witnesses ..... 155 2/E6
General Accounting Office ..... 239 2/D8
Department of Housing and Urban Development ..... 277 2/G5
Nondepartmental witnesses ..... 349 3/E8

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# MANAGEMENT OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT'S INVENTORY OF MULTIFAMILY PROPERTIES

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TUESDAY, NOVEMBER 13, 1979

U.S. SENATE,
SUBCOMMITTEE ON HUD-INDEPENDENT AGENCIES
COMMITTEE ON APPROPRIATIONS,
*Washington, D.C.*

The subcommittee met at 10:05 a.m., in room 1318, Everett McKinley Dirksen Senate Office Building, Hon. William Proxmire (chairman) presiding.

Present: Senators Proxmire and Mathias.

## NONDEPARTMENTAL WITNESSES

### OPENING STATEMENT OF SENATOR PROXMIRE

Senator PROXMIRE. The subcommittee will come to order.

This morning we will take testimony on the events surrounding the Clifton Terrace affair.

Clifton Terrace, of course, is a HUD-held property that was first managed and then purchased by P.I. Properties, Inc., of Washington, D.C., which proceeded to make four mortgage payments in 3½ years and, according to press accounts, systematically "milked" the project at the expense of the American taxpayer.

On Saturday, November 3, I visited Clifton Terrace for 2 hours. I talked to tenants and went into the buildings. I can speak at first hand about the dilapidated condition of the buildings and the deep concern of the tenants.

An examination of the facts and documents in the Clifton Terrace case makes it clear that both the taxpayer and the Clifton Terrace tenants were victimized by an incompetent bureaucracy—a bureaucracy which seemed incapable of taking even the most elementary precautions months after it was clear that something was seriously wrong.

### REFERENCE TO HUD REPORTS

Let me briefly refer to those documents to indicate just how inept the HUD bureaucracy was in handling the case. In a May 27, 1977, audit report, HUD found that P.I.'s records were completely inadequate and called for the "reconstruction and/or establishment of required accounting records."

Pursuant to this recommendation, the president of P.I. Properties, Mary Treadwell, wrote to HUD on July 29, 1977—2 months after the audit—that "Arthur Anderson & Co. is expected to perform a review of the 1974 records within the next 2 weeks."

Almost 1 month later—on August 22, 1977—a memorandum from the Washington area HUD office stated, "Arthur Anderson & Co. is expected to perform a review of the 1974 records within a week." Another 2 months went by before an October 17 letter from HUD's Housing Management Division to Mary Treadwell stated, "Although no contract has been executed with Arthur Anderson & Co., you indicated that it is expected that they will schedule their financial audit sometime in November 1977." Of course, P.I. never signed a contract with Arthur Anderson to perform such an audit, yet months were lost while HUD waited for an audit which never took place and for which there was never any contract.

In other words, we had a situation here that demanded prompt and decisive action, yet the HUD bureaucracy simply sat on its hands and did next to nothing.

### HUD INVESTMENT IN CLIFTON TERRACE

How much has this exercise in bureaucratic negligence cost the United States? HUD's current net investment in the property is $5,936,079.60. Most of this total represents the amount HUD paid to the bank when HUD first took over the property. However, it includes over $234,000 in advances for such expenses as water and sewer charges, heating costs and tax payments, and over $1 million for repair and rehabilitation.

### MORTGAGE PAYMENTS AT CLIFTON TERRACE

How about the mortgage payments on Clifton Terrace? What kind of a job did P.I. do in meeting its monthly mortgage obligation? Out of a total of 32 payments due the Federal Government, P.I. made 4. Out of a total of $296,000 due the Federal Government, P.I. paid $44,487.61. Yet, for more than a year after the May 27, 1977, Inspector General's audit showing serious problems, HUD did not move to foreclose. In fact, the incomplete record strongly suggests that efforts to foreclose were sidetracked within the Department. We'll be touching on the reasons why this morning.

### RECOGNITION OF WITNESSES

Today, we'll be hearing from the Clifton Terrace Tenants Association regarding their frustrating attempts to communicate with HUD concerning the P.I. takeover—attempts that were met with neglect and indifference.

We will hear from the General Accounting Office regarding the facts in the case and the implications the Clifton Terrace fiasco has for HUD's total property management program.

Finally, we will hear from two HUD employees—past and present—whose warnings about Clifton Terrace went unanswered. Unfortunately, we will be unable to hear from the Secretary of Housing and

Urban Development today because of a prior commitment. We plan to take his testimony later.

### OTHER POSSIBLE PROBLEM AREAS CREATED BY HUD INACTION

Although this subcommittee is deeply disturbed by the specifics in the Clifton Terrace case, it is much more distressing to realize that this may simply be the tip of of the iceberg. If the Department has been so obviously inept about handling a project in its own backyard of Washington, D.C.—a project which you can see from the Capitol—how many Clifton Terraces are there in New York, Chicago, Los Angeles, and elsewhere in the country? How many low- and moderate-income tenants are being victimized and cheated because of HUD inaction? How many millions of tax dollars are being utterly wasted? HUD holds, by rough estimate, $3 billion worth of mortgages in its inventory. Is this inventory composed of dozens of time bombs waiting to explode? That's the bigger issue we must keep in mind today as we consider the unsavory facts in the Clifton Terrace matter.

### INTRODUCTION OF WITNESSES

Our first witnesses are representatives of the Clifton Terrace Tenants Association.

I will ask them to come forward at this point. They are Mr. Dick Jones, Mr. George Blackwell, Mr. Lynn Cunningham, Ms. Gussie Jackson, and Mr. Eugene Jacquet.

Do each of you folks have statements?

Mr. Jones. Two people will; Mr. Blackwell and Ms. Jackson.

Senator Proxmire. The first statement is by?

Mr. Jones. Mr. George Blackwell.

Senator Proxmire. Go right ahead, sir.

## Clifton Terrace Tenants Association

**STATEMENTS OF:**
**DICK JONES**
**GEORGE BLACKWELL**
**LYNN CUNNINGHAM**
**GUSSIE JACKSON**
**EUGENE JACQUET**

### SITUATION IN CLIFTON TERRACE

Mr. Blackwell. The Washington Post's recent series of articles about Clifton Terrace shocked and dismayed me as the past president of the Clifton Terrace Tenants Association. I was shocked and dismayed because we, the tenants, had known from the beginning that Mary Treadwell Barry and P.I. Properties should not have been permitted to own or manage Clifton Terrace.

My name is George Blackwell, a tenant. I appreciate the opportunity to be able to testify before you today, Mr. Chairman and members of the committee. Good morning.

I have lived in Clifton Terrace for 15 years. I was there when Sidney

Brown owned the buildings and I was there when the city government finally took action against him with respect to the hundreds of housing code violations that he had allowed to accumulate there. He—Sidney Brown—was my landlord. The city government, after prosecuting Mr. Brown, went to the Department of Housing and Urban Development, along with the Housing Development Corporation, and was successful in convincing HUD to use their authority under the Housing Act to make Clifton Terrace a 221(d)(3) program for rehabilitation.

### EFFECTS OF BARRY/P.I. PROPERTIES MANAGEMENT

Mr. Chairman, I stuck out the process with the Tenants Association and the HDC only to find myself in the present state of affairs with housing violations and rats and roaches.

In 1974 when Under Secretary H. R. Crawford and HUD Secretary Carla Hills made the deal, the Tenants Association said that the deal should not have been made with Mary Treadwell Barry and P.I. Properties because there was no basis or track record to believe that this organization could do a good job of managing Clifton Terrace.

That deal and the resultant Mary Treadwell Barry management caused tenants to suffer from slum conditions including property deterioration, winters without heat or hot water, and a repetition of all the old conditions that we, as tenants, organized against.

Senator, we, over the years, have said over and over again to the city and Federal Government officials that P.I. Properties should not have been permitted to manage or own Clifton Terrace. In this regard we have put together a package of material that we think will reveal to you and your committee all of the tenants', and their attorneys', efforts in trying to resolve the present situation.

All these years no one would listen to us. We are taking this opportunity to submit to you for the record copies of correspondence, newspaper articles, press releases, and other documents that we believe show that tenants have been protesting the horrible job that Mary Treadwell Barry and P.I. Properties did at Clifton Terrace.

We further believe that this information is important because it shows that the people who live in subsidized housing are the only ones able to oversee the operation of that housing.

The tenants of Clifton Terrace have the best opportunity to see and know what is going on in the buildings and the incentive to catch people who are not doing things in their best interests.

The one thing that the residents of Clifton Terrace needed and did not have, was power to put into effect their views of what should be done and when, and their determination that things be done to make their living situation better.

### TENANT CONTROL OF CLIFTON TERRACE

The most useful and important thing that we are hoping that will come out of these hearings is a determination by Congress and HUD that tenants will be given power and authority to control their living environment.

In the nature of things, Senator Proxmire, we communicated with Members of the Senate and House of Representatives, but we understand that it is very difficult for anyone of you to respond favorably to our complaints. Each of you must get many complaints from constituents and we know you do not have enough staff to check them all out.

However, HUD has staff but the Department's priorities seemingly have not placed them in the job of keeping track of maintenance and operation of the thousands of units of housing that HUD owns and controls. We feel that there is no way that HUD will ever have enough staff to do the job. We have concluded that the best way to assure that HUD-owned buildings are well maintained, decently kept, provided with front doors, provided with heat and hot water, and kept free of rats and roaches is to give the residents who live in the buildings the power and the ability to make certain that it happens.

## 1967-73 MANAGEMENT PERIOD AT CLIFTON TERRACE

I had the privilege of being the president of the Clifton Terrace Tenants Association during the period when the Housing Development Corporation ran the complex from 1967 to 1973 as the manager, then as purchaser and redeveloper from Sidney Brown.

During this period HDC afforded the tenants a substantial role in the management of the property. The Tenants Association got an income and expense accounting every month and participated in making decisions on how the available money would be spent. We also had the power to decide when a tenant would be evicted and the Tenants Association had the responsibility of evicting those tenants.

## HUD FORECLOSURE ON PROPERTY

HUD foreclosed on the property in 1973 and became the owner. The tenants have had no role in the management and operation of the project since that time. Tenants had a major role in the running and operation of the project in 1969 when HDC was the owner and manager; and now in 1979 with the Federal Government as the owner, tenants have no control over the management and operation of the project.

We believe that this is a terrible mistake and a terrible waste.

Senator Proxmire, we, the tenants, want to take on the management of Clifton Terrace now. We are a community organization and have been living in the buildings for over 15 years. Many of us have management experience from the HDC days and from other situations. The Tenants Association might manage the property directly or we may make the decision to contract the responsibility to another firm. However, what we think is absolutely essential is that the power to make management decisions be placed in the residents.

The reason that we know that we would do a good job, Senator, is because this project is our home. Senator, you have been there and two staff members have been there. You should understand from your own visit to the project that we would do a better job than those who are presently running the project

READEX FICHE

### TENANT PRIORITIES AT CLIFTON TERRACE

We raise the following as examples of things that would be our priorities: A front door and side door in the west building—1350 Clifton Street—so that the heat would not escape out of the openings where those doors are supposed to be; windows would be replaced; the security system guards' intercoms and closed circuit television would be put in place and functional. We are the people that need it. Empty apartments would be made livable for the many people that need them now, rather than serving as health and fire hazards as is presently the case. Halls would be painted, lights would function, and elevators would operate. These are things that affect us daily.

We think that we should be given the opportunity to deal with our living situation now. We want to be sure that any arrangement that is made provides us with enough money so that we do not become another inner city—ghetto—statistic. This will require some subsidy from the Federal Government since housing in this area is so expensive.

We are prepared to do our part seeing to it that the buildings are well maintained, that energy is conserved, and that empty units are used by people who need them most.

Finally, Senator, this project, Clifton Terrace, has been a vital part of our American dream. Part of the rehabilitation in the heart of the ghetto involved transforming one- and two-bedroom units into three- and four-bedroom units. The work was largely done by black contractors, craftsmen, and laborers who were able to be brought into the unions.

We did not have to displace the people who were living in the buildings. The people who lived here worked on the job. Tenants were intimately involved in the operation, maintenance, and management of the project.

HUD, in its wisdom, after taking title and then giving the property to P.I. Properties in 1974, frustrated all of these important objectives. We now have the opportunity to reclaim the project for the people. We, the tenants, are the only people willing and able to manage, own, and monitor Clifton Terrace every day.

It is in our best interest. Help us reclaim our dream. Everyone has failed us since 1973. It is long past time for someone to assist us in a last ending to this saga.

Thank you.

Senator PROXMIRE. Thank you, Mr. Blackwell.

Ms. Jackson?

### STATEMENT OF GUSSIE JACKSON

Ms. JACKSON. My name is Gussie Jackson. I am a community organizer for the United Planning Organization. I was a tenant and an organizer in the sixties for the Clifton Terrace project. I was one of six persons chosen to work on the Clifton Terrace project, which was a special project because of the horrible conditions that existed there. Living there gave me certain insights into what the problems really were and how to go about solving them. We worked on a daily basis and I worked from sunup to well after sunset, organizing the tenants association and delivering social services assistance. I was proud of my job and role because I felt that I was helping people and myself out of the dilemma that we discovered we were in.

### CONDITION OF PROJECT AFTER BARRY-P.I. PROPERTIES TOOK CONTROL

I noticed that prior to 1973 when Mary Treadwell Barry and P.I. Properties took over the complex, tenants had begun to exert some control over their living environment. However, when Mary Treadwell Barry and P.I. Properties came to Clifton Terrace, the three buildings went into progressive stages of deterioration.

I was bombed out of my apartment by the District of Columbia Police Department on June 29, 1979, in their effort to deal with a deranged person that had barricaded himself into the apartment next door to mine. The police had to use grenades to dislodge the man and, as a consequence, my apartment was burned out.

I was moved to another apartment in the complex that was not to my liking and, subsequently, I moved to a newly built subsidized project.

I have never been compensated for the loss of practically everything that I owned from that incident.

So, you see, Senator I am and have been very bitter considering the plight that I was placed in. There is no question in my mind that the tenants can and will manage and operate the project better than all of the management entities that have come down the pike.

We have organized a management company to assist in dealing with or managing the Clifton Terrace project.

We are prepared to manage the project. We have the experience and we know that we can do the job.

Senator PROXMIRE. Thank you very much, Ms. Jackson.

I want to thank both of you for your very moving and impressive statements.

### FHA COMMITMENT TO RESIDENTS

Mr. Blackwell, according to a June 7, 1974, letter from you to then Secretary of HUD James Lynn, the executive committee of the Tenants Association—you were speaking, I presume for them—had "appealed to the FHA area office in October, November, December of 1973, and on February 5, 1974, concerning the management and future disposition of the project."

You went on to say, Mr. Blackwell, that FHA gave the tenants a firm commitment that "residents would have input in an advisory capacity in selection of management companies, review of management plans . . . capital improvements in the property, and final disposition and ownership of the property."

Mr. BLACKWELL. That is correct, sir.

Senator PROXMIRE. Did the tenants have any input into the selection of P.I. Properties as the new project manager?

Mr. BLACKWELL. Not at all, sir.

Senator PROXMIRE. None?

Mr. BLACKWELL. Not at all, sir.

Senator PROXMIRE. I am going to ask the other witnesses to speak up if they have anything to add to Mr. Blackwell's responses or wish to contradict or affirm his answers. I don't have questions for each individual witness. I thought I would address the questions to Mr. Blackwell and if the rest of you want to respond, you certainly may.

Mr. JONES. We also have a chronology we will submit for the record.

Senator PROXMIRE. Very good Mr. Jones.

Mr. JACQUET. Senator Proxmire, for the record, I would like to know why was it that H. R. Crawford was permitted to give Clifton Terrace to P.I. Properties when HUD had already spent over $3 million trying to rehabilitate the property, why would they turn around and give this property away for $800,000?

Senator PROXMIRE. Well, that is an excellent question. I am delighted you raise it, because that is a question we want to ask of HUD, too.

We intend to do that when they come before us a little later on. I am glad you raised the question. I don't have an answer myself.

### ACHIEVEMENTS OF P.I. PROPERTIES

I would like to ask Mr Blackwell about a March 18, 1975, memorandum from the then director of the D.C. area office, Harry W. Staller, to H. R. Crawford. The memorandum lists, among other things, six "achievements" of P.I. Properties during their first 11 months as managers of Clifton Terrace. They are as follows:

One, from April 1974 to June 1974—that is a period of only 3 months but that is the information they have here—complaints from tenants were reduced by 75 percent.

Two, there has been a noticeable decrease in expenditures for vandalism. Also, police calls for related problems have been reduced from a monthly average of seven as of April 1974 to less than two a month.

Three, landscaping and other imaginative decorating has improved the appearance of the property.

Four, tenants are assuming far more responsibility as citizens concerned with maintaining law and order. Several tenants have cooperated with the police department in the arrest of at least three narcotic suspects on the premises, and that is a new phenomenon.

Five, they have established several programs for senior citizens and youths and have cooperated with other government agencies to bring services to the tenants group.

Six, the average number of days when vacancies exist has been greatly reduced, even though the turnover rate continues to fluctuate from month to month.

Would you comment on those achievements—the achievements are confined to the first 11 months of P.I. management, obviously. There may have been a better picture then than there is now.

Were those genuine achievements? How do you react to the list?

Mr. BLACKWELL. On your first one——

Senator PROXMIRE. The first statement was complaints of tenants were reduced by 75 percent in the first 3 months.

Mr. BLACKWELL. Is that during the time P.I. Property was there?

Senator PROXMIRE. Yes; these claimed achievements were the basis on which HUD let P.I. Properties go ahead, apparently, and assume management and ownership.

Ms. JACKSON. May I answer that?

Senator PROXMIRE. Yes.

Ms. JACKSON. That was because they wrote that statement themselves.

Mr. JACQUET. Right.

Ms. JACKSON. The tenants didn't write that.

Senator PROXMIRE. That is right. I am asking you if you want to challenge that statement.

Ms. JACKSON. I challenge it.

Senator PROXMIRE. OK.

Let me just run down the claims P.I. Properties made very quickly.

### REDUCTION OF TENANT COMPLAINTS

In the first place, complaints from tenants were reduced by 75 percent.

Mr. JACQUET. That is not right.

Senator PROXMIRE. How do you know it is wrong?

Mr. JACQUET. We live there.

Ms. JACKSON. We live there.

Senator PROXMIRE. You didn't see any improvement?

Ms. JACKSON. I can tell you what was happening. We had intercoms; we had a lot of things that were put there——

Senator PROXMIRE. Vandalism——

Ms. JACKSON. The intercoms were taken out because she said we were not the right people for them. Other things were taken away.

Senator PROXMIRE. How about the landscaping and improvement——

Ms. JACKSON. She kept that nice out there, but inside things were deteriorating. The landscaping was beautiful, but we lived inside.

Mr. JACQUET. It was a show, a front.

Senator PROXMIRE. How about the program for senior citizens and youths? Did they establish——

Mr. JACQUET. She did away with that.

Senator PROXMIRE. She did away with it?

Mr. JACQUET. We already had that. She closed the room up on them. They couldn't hold meetings.

Ms. JACKSON. We had to get permission 2 weeks before time to have meetings. An agenda had to be sent to her so she knew what we were saying.

### REMOVAL OF APPLIANCES BY P.I. PROPERTIES

Senator PROXMIRE. Mr. Blackwell, a Washington Post story indicated that on July 13, 1977, HUD area office staffer Jack Gifford wrote a memo for the files indicating that he received a call from a Clifton Terrace resident saying that "P.I. Properties were hauling refrigerators, stoves, toilets, plumbing parts" and so forth, off the premises.

Apparently HUD's reaction was to call the P.I. project manager, who referred to this as normal replacement activity.

Can you comment on this incident and tell us what action, if any, HUD took to check into this situation other than call the P.I. employee at Clifton Terrace?

Mr. JACQUET. I can answer that. Being a security guard and working for the Tenants Association and also for P.I. Properties, I have often seen trucks sitting out there in the back of the building with frigidaires and stoves on them going, rather than coming, to Clifton Terrace. The trucks were going away, not coming to the project.

Senator PROXMIRE. And HUD didn't, as far as you know, check any further. They didn't come out to interview you or other tenants?

### RENT INCREASE REQUEST

Mr. JACQUET. Not that I know of.

Senator PROXMIRE. In June of 1977, Mr. Robert E. Lee, general manager of Clifton Terrace, was quoted in the Afro-American as saying:

> We need an immediate rent increase if the building is expected to meet its operating costs. The rents simply aren't high enough to cover our utilities and operating costs. We are presently running at a $6,000 to $7,000 a month deficit.

Did P.I. provide any information to the tenants during this period to back up their claim of insufficient revenues to meet operating costs at Clifton Terrace, and what type of input did the tenants have in reviewing P.I.'s financial statements with HUD—any?

Mr. BLACKWELL. No. 1, not any. No. 2, not any.

Senator PROXMIRE. Now, Mr. Blackwell, you have been at Clifton Terrace for a number of years, I understand.

Mr. BLACKWELL. Since March of 1963.

Senator PROXMIRE. And you have been an official in the tenants organization during much of this time?

Mr. BLACKWELL. Nine years. President of Clifton Terrace Tenants Association.

Senator PROXMIRE. So you would be in a position to know if P.I. had made any effort to discuss this with the tenants?

Mr. BLACKWELL. There was no communication between the tenants and P.I. at any time whatsoever the whole time they were there.

Senator PROXMIRE. So you had no opportunity to comment on this claimed deficit of $6,000 to $7,000 a month. Did you have any knowledge of it or have any input?

Mr. BLACKWELL. No knowledge whatsoever.

Senator PROXMIRE. What has been your capacity with the Tenants Association during this time?

Mr. BLACKWELL. That particular time?

Senator PROXMIRE. Yes.

Mr. BLACKWELL. Or now?

Senator PROXMIRE. During the last several years.

Mr. BLACKWELL. President of the Clifton Terrace Tenants Association.

Senator PROXMIRE. Is there any other group of tenants who P.I. might logically discuss this with, other than yourself, or is yours the only tenant association there is?

Mr. BLACKWELL. You have the Senior Citizens Association that we set up that you could discuss it with.

Mr. JACQUET. Yes; but they wouldn't——

Senator PROXMIRE. But weren't the senior citizens a particular group, not fundamentally concerned with overall tenants' problems?

Mr. Blackwell. We had no communication at all with P.I. Properties, none at all.

Mr. Jacquet. They discussed nothing with the Tenant Association, no properties or anything.

### TENANT NEGOTIATIONS WITH JONES, WELLS & ASSOCIATES

Senator Proxmire. According to the Washington Star account of HUD's foreclosure of Clifton Terrace on August 23, 1978, HUD negotiated a contract with the property management firm of Jones, Wells & Associates of Washington, D.C., "on an emergency basis" with no competitive bidding.

As you know, no competitive bidding was used in negotiating the contract with P.I. Properties in May of 1974.

What input, if any, did the Clifton Terrace tenants have in negotiating with or reviewing the credentials of Jones, Wells & Associates in 1978—any?

Mr. Blackwell. Very little.

Senator Proxmire. What did the very little amount to?

Mr. Blackwell. We had a conference with them once or twice.

Senator Proxmire. You had a conference with P.I. Properties about this firm?

Mr. Blackwell. We had priorities we told them we would like for them to submit to HUD. That was only once that happened.

Senator Proxmire. Did you have this discussion with Jones and Wells?

Mr. Blackwell. With Jones and Wells. I think it was a September, if I am not mistaken. We had a conference with Jones & Wells and the manager, Mr. Stevenson. I think he was the manager for Jones and Wells. At that particular time we had priorities that we asked Mr. Stevenson to submit to HUD, things that we would like for HUD to do.

We also asked them for expenditure sheets, disbursements, which we did not get until later, in January, February, and March. Eventually we got those three. but after that, we got nothing else.

Jones and Wells came in——

Senator Proxmire. Did you request additional information after that?

Mr. Blackwell. We requested the information after HUD had bought Clifton Terrace back. This happened to be in September, if I remember correctly, August 23, I think, 1978, when Mr. Chisolm bought Clifton Terrace back.

On the night of the 23rd after we returned to Clifton Terrace, there were 17 guards up there. When I say "guards," I mean security men without any guns or anything; just nightsticks.

So we went to the office to see what was going on and they told us that they were there to protect the office; that is, the P.I. Property office. I imagine they represented Jones & Wells. Come to find out, they were getting $5,000 a month for managing the project and weren't doing a thing, weren't doing one thing. It's almost as bad as when Pomponio Brothers had it and that was before P.I. Properties had taken over.

Senator **Proxmire**. Have there been improvements in the last 6 months?

### CONDITION OF VACANT APARTMENTS

Mr. **Jacquet**. I don't see it, sir. Anytime you can walk in that hallway and those vacant apartments, any woman or any person can be robbed. Those apartments are vacant; doors are off. You can be snatched in any one of them, even you. If you walk in those apartments, which you didn't see, they told you you couldn't go to see probably, but if you went in any one of them that were vacant—there is a whole unit of them, a whole unit in the west building——

Senator **Proxmire**. In the building that had the fire?

Mr. **Jacquet**. Yes; I can walk you in there now and walk you in a whole lot of those vacant apartments, doors are open. This is what we want locked. If you can't repair them right away, lock them up.

Senator **Proxmire**. You say those vacant apartments are unlocked?

Mr. **Jacquet**. Yes.

Senator **Proxmire**. Therefore, they are open to vandalism and anybody can rip the apartments off.

Mr. **Jacquet**. There is another thing, Senator. When an apartment became vacant with P.I. Properties, why wasn't the apartment fixed up so someone could move right back in? They didn't do that. What they did was strip the apartment. They even went and took out the garbage disposal, the frigidaire, the stove, the sink, the commode, bathtub. They just took it all out of there. And you wouldn't know anything. Then the next thing they would do is leave the door open so when you go to the apartment they could say somebody stole the stuff or somebody vandalized it. Actually, they did it.

Senator **Proxmire**. This is my last question for this group of witnesses.

### IMPROVEMENTS IN LAST 6 MONTHS

Let me ask you right down the line, starting with Mr. Jones. Have you seen any improvements in the last 6 months?

Mr. **Jones**. No, Senator; I have not. As a matter of fact, the building is deteriorating now at a faster rate than it was 6 months ago.

Senator **Proxmire**. Ms. Jackson?

Ms. **Jackson**. No; I haven't.

Senator **Proxmire**. Mr. Blackwell?

Mr. **Blackwell**. No.

Senator **Proxmire**. Mr. Jacquet?

Mr. **Jacquet**. No.

Senator **Proxmire**. Mr. Cunningham, you are the lawyer for the tenants. Do you know, in your professional capacity as counsel, of any improvements?

Mr. **Cunningham**. No, I don't. The tenants have not reported to me any significant improvements at all.

Senator **Proxmire**. I want to thank you very, very much for very helpful testimony. We are in your debt for making the clear record that you have made. We will take up your complaints with HUD.

# GENERAL ACCOUNTING OFFICE

## COMMUNITY AND ECONOMIC DEVELOPMENT DIVISION

## STATEMENT OF HENRY ESCHWEGE DIRECTOR, COMMUNITY AND ECONOMIC DEVELOPMENT DIVISION, GAO

**ACCOMPANIED BY:**
**KEITH FULTZ**
**RICHARD WOODS**

### INTRODUCTION OF ASSOCIATES

Senator PROXMIRE. Our next witness will be Mr. Henry Eschwege, Director of the Community and Economic Development Division General Accounting Office.

Mr. Eschwege will testify now regarding the facts surrounding Clifton Terrace.

We are delighted to have you with us today, Mr. Eschwege. Go right ahead. You might introduce the distinguished gentlemen with you.

Mr. ESCHWEGE. On my left is Mr. Richard Woods, who is in charge of our work in the housing and community development area. On my right is Mr. Keith Fultz, who is the audit supervisor charged with responding specifically to your request.

We are here today at your request to discuss what we know of HUD's management and monitoring of the Clifton Terrace Apartments in Washington, D.C., and certain past and present GAO reviews of HUD's management of its multifamily mortgage programs.

Currently, the Department of Justice is conducting an investigation of the Clifton Terrace project which could result in criminal proceedings. Therefore, our discussion this morning will concentrate only on HUD's administrative management and monitoring of the project. The Department of Justice has subpenaed the HUD files in this project and, as a result, our recent inquiries have been conducted without the benefit of complete project files.

The information which we have obtained from available files indicates that HUD sold the Clifton Terrace property to P.I. Properties, Inc., under unusual circumstances; inadequately monitored the activities of the new owners; and delayed foreclosure on the project despite indications of serious financial problems.

### EVENTS SURROUNDING PROJECT

To fully understand the circumstances leading to HUD's foreclosure in August 1978 of the Clifton Terrace project, let me present a brief description of events concerning the project.

HUD acquired the property on April 2, 1973, by foreclosure after the previous owner had defaulted on the HUD insured mortgage. The project was presented to HUD's Property Disposition Committee on February 6, 1974, with a recommendation for a public offering at a minimum price of $1,202,000 with a Secretary-held mortgage of 90 percent. On May 16, 1974, HUD entered into an agreement to sell the project to P.I. Properties, Inc., for $1,286,600, on a noncompetitive basis, with a 100-percent Secretary-held mortgage. The sales agreement provided that P.I. Properties, Inc., was to manage the project as an agent for HUD until December 1, 1974. Closing on the property was scheduled for December 2, 1974, contingent on satisfactory management of the project during the interim period.

Actually, closing did not take place until June 30, 1975. HUD officials told us that selling the project without competitive bidding and financing it with a 100-percent Secretary-held mortgage was not a common procedure. A HUD official prepared a waiver of criteria to negotiate sale to justify the deviation from normal practices.

### PROBLEMS DURING P.I. MANAGEMENT

HUD's analysis indicated that there were some problems with the management of the project during the period that P.I. Properties, Inc., was the management agent.

For example, in a March 18, 1975, memorandum to the Assistant Secretary for Housing Management, the area office director discussed P.I.'s performance and recommended that P.I., Inc., not continue managing the project. Also, the tenant organization at Clifton Terrace had indicated its dissatisfaction with P.I.'s management.

Despite the identified problems during the interim management period, the project sale was closed on June 30, 1975, at a sale price of $820,400—some $400,000 less than the recommended and the previously agreed to sale price—with a 100-percent Secretary-held mortgage.

### P.I. ACTIVITIES DURING MANAGEMENT PERIOD

Our examination of agency documents indicates that after the sale, P.I., Inc., failed to provide HUD with the required financial statements which would have permitted an analysis of the quality and effectiveness of project management. This, coupled with the fact that P.I. was not making monthly mortgage payments to HUD, caused HUD headquarters officials, as early as September 1976, to question whether P.I. would meet its obligation and whether the mortgage should be foreclosed. In all, P.I., Inc., made only four payments on the mortgage, and as of May 1, 1977, P.I. was about $193,000 behind in mortgage payments.

### HUD AUDIT

On May 27, 1977, the HUD Inspector General's Office issued the first audit report on the project's operations and concluded that the books and records were incomplete, were inaccurate, and, in some instances, could not be located. The report also concluded that a comprehensive audit could not be performed until deficiencies in the financial records were corrected.

On that same date, the Inspector General's Office wrote the area office director concerning the audit. The letter criticized the area office's servicing of the project, stated that the mortgagor had not been required to submit annual financial statements, and said that monthly financial reports submitted to the area office by project officials were not fully utilized.

On June 20, 1977, the area office director recommended to the Director, Office of Loan Management in HUD headquarters, that the mortgage be foreclosed based on the lack of responsible and efficient management. In a separate action on June 22, 1977, electric service to the project was discontinued briefly because of delinquent bills amounting to about $91,000.

On August 3, 1977, the area office director requested that his earlier foreclosure recommendation be held in abeyance. He stated that he believed improvements could be made in 90 days. Although the situation at Clifton Terrace did not improve, HUD did not foreclose on the mortgage for another year, or until late August 1978.

### MORTGAGE DELINQUENCIES

I would like to point out that a number of the problems at the Clifton Terrace project are not unique. HUD currently holds the mortgages on about 2,000 multifamily projects valued at over $3 billion. About 75 percent of these projects are delinquent in their mortgage payments. Estimates of these delinquencies total as high as $500 million. There are about 500 additional projects which HUD owns as a result of mortgage foreclosures.

Senator PROXMIRE. That is an astonishing statement. About 75 percent of these projects are delinquent in their mortgage payments and we are talking about over $3 billion in mortgages and 2,000 multifamily projects.

Mr. ESCHWEGE. That is correct.

Senator PROXMIRE. 75 percent are delinquent?

Mr. ESCHWEGE. That is correct.

Senator PROXMIRE. Go ahead. I wanted to make sure I was hearing you correctly.

Mr. ESCHWEGE. Problems of defaults, inadequate monitoring, inadequate mortgage servicing, and lengthy periods between default and foreclosure have been noted in other GAO reports and testimony. HUD's Inspector General's first semiannual report to the Congress on April 30, 1979, stated that their audit reports have often disclosed the lack of monitoring and on-site reviews of the activities of program participants by HUD program personnel.

### PROBLEMS REVEALED BY FIELD AUDITS

Past GAO reports and our congressional testimony on this subject have identified such problems as:

Field offices being ineffective in exercising control over receipts and disbursements; failure to maintain project books and records in reasonable condition for audit or for showing results of operations; inadequate management and monitoring of multifamily projects; administrative actions taken on a case-by-case basis without establishing an explicit policy regarding workout agreements or foreclosures; and increasing delinquencies during workout periods.

### STRATEGY EFFECTIVENESS

Currently, GAO has several reviews related to HUD's multifamily programs. We are reviewing the departmental decisionmaking process which resulted in HUD's "troubled projects" strategy and the potential effectiveness of the strategy in treating the financial problems in subsidized projects.

We are addressing certain areas of strategy effectiveness which may be of interest to the subcommittee, including: Reversals of HUD field judgments regarding owner/management effectiveness; potential costs of the flexible subsidy program and HUD/owner cost sharing; and HUD/owner evaluation of project expenses and management and the adequacy of responses to problems.

We are completing a review of HUD's accounting system for multifamily assigned mortgages. During this review, we have noted that the HUD system is unable to identify the total amount of delinquent mortgage payments. We estimate, as I stated before, the delinquencies to be about $500 million and we are in the process of determining the causes for the delinquencies. HUD is not using two important management tools on these mortgages: The monthly financial statements required from project owners; and the annual audit reports required from independent public accountants. In many cases, these statements and reports are not received by HUD and, when they are received, they are often not reviewed in any detail.

### HUD MANAGEMENT CAPABILITIES

Further, in a review of HUD's management of its acquired formerly subsidized projects which we are conducting for the Subcommittee on Manpower and Housing, House Committee on Government Operations, we are addressing the issues of whether HUD has: Adequate control of information on project operating expenses; cost standards to evaluate the reasonableness of expenses; and monitors project operations adequately.

In summary, our past and ongoing reviews have shown that HUD has great difficulty managing some 2,500 multifamily projects which it holds in its inventory or on assignment. We hope that the recent dramatic disclosures regarding Clifton Terrace will serve to underline the need for a broad range of substantive actions by HUD to deal with the problems exemplified by this project.

This concludes my prepared statement.

We shall be glad to respond to any questions you may have.

Senator PROXMIRE. Thank you, Mr. Eschwege, very much.

### INADEQUACY OF AUDIT

Mr. Eschwege, from all the information that has become available thus far, it would appear the May 27, 1977, audit of P.I. Properties, Inc., by HUD's Office of Inspector General was completely inadequate. Discrepancies apparently appeared on monthly disbursement sheets P.I. filed with HUD that should have indicated that an investigation of the project was warranted.

In fact, these discrepancies must have gone unnoticed because they were not mentioned in the audit report. For example, the July 1976 monthly report to HUD by P.I. listed a $3,160 charge for management fee—July. But in the August report another $3,039.90 was charged for July management fee. Shouldn't this have been picked up by any kind of a thorough audit?

Mr. ESCHWEGE. Yes, Mr. Chairman, we have examined these reports and, as you say, the items do seem to be duplicative payments.

We believe it should have been questioned by both the HUD area office people responsible for receiving and looking at these reports and the auditors who later examined the transactions.

Senator PROXMIRE. Is it possible that this was simply an activity costing, say, twice as much, and therefore the July fee should have been $6,100 or $6,200 or something of that kind? Would that explain it?

Mr. ESCHWEGE. No; because we had gone back to other monthly statements and we can account for entries in about the same amount for other months, such as August; we went back to June as well.

Senator PROXMIRE. This looks, then, like just a straight overpayment.

Mr. ESCHWEGE. That is what it looks like, a duplicative payment.

### LOAN TO PRIDE ENVIRONMENTAL SERVICES

Senator PROXMIRE. The November 1976 Clifton Terrace accounting shows a $3,000 loan to Pride Environmental Services. Apparently this was against HUD regulations. A loan should not have been charged against project income, especially if the mortgage payment could not be made.

Shouldn't a thorough audit have picked up this improper transaction?

Mr. ESCHWEGE. Yes; this should have been picked up by a detailed audit.

Senator PROXMIRE. The December 1976 disbursement sheet indicates that P.I. used $6,700 to repay loans. These payments should not have been made until P.I. made good on delinquent mortgage payments. Other loan repayments were listed in January, $2,000; February, $4,976; and March, $1,500. This was in 1977. These improper transactions were not mentioned in the May 27 audit report.

Shouldn't they have been detected by the auditors?

Mr. ESCHWEGE. Again, a detailed audit of Clifton Terrace would have revealed these kinds of payments.

Senator PROXMIRE. You say a detailed audit. Wouldn't any kind of a respectable audit disclose that information? It wouldn't have to be detailed?

Mr. ESCHWEGE. Mr. Chairman, what I am trying to say, knowing the background of this project, knowing the difficulties that have gone before it, one would have made a detailed audit. There are some instances where, perhaps, things appear clean and you don't have to go into such detail. But here was a situation where a project has had problems before it was even purchased by P.I., Inc., and I think auditors would be on notice that this requires a detailed audit.

### FLUCTUATIONS IN LAUNDRY INCOME

Senator PROXMIRE. There is one spectacular inconsistency, it seems to me, that should have been picked up right away. An examination of the monthly reports on Clifton Terrace shows great fluctuations in laundry income. For example, the March 1977 report shows $1,278 in income for a 2-month period. The May 1977 report shows only $40.88 in laundry income. The July 1976 report shows $806 in laundry income, yet there is no laundry income reported for the following 3 months. Shouldn't this irregular income pattern have been picked up by the 1977 HUD audit?

Mr. ESCHWEGE. Mr. Chairman, Mr. Fultz has looked at this particular problem.

Mr. FULTZ. We have reviewed this record, sir, and this should have been questioned in the audit that was made.

During the period of 12 months, for the records we did review, we could only find entries of laundry income for 6 of those months. For the other 6 months, nothing was listed.

This figure could amount to as much as $10,000 or $12,000.

Senator PROXMIRE. Is there any possible explanation? I went down to the laundry room in one of the units. I noticed they had a coin-operated laundry. Did the laundry income come from these coin-operated units?

Mr. FULTZ. Yes; it did, sir.

Senator PROXMIRE. Is it conceivable that the laundry could have been out of commission for a month or wouldn't that be possible, in all the units?

Mr. FULTZ. I don't think so. Maybe the Tenants Association——

Senator PROXMIRE. I am sure the Tenants Association will let us know loud and clear on that one. So somehow 6 months of income from the coin-operated laundry just disappeared?

Mr. FULTZ. There is no record on the financial statements reported to the HUD area office.

### REVIEW BY GAO TASK FORCE ON FRAUD AND ABUSE

Senator PROXMIRE. One of the two auditors who performed the May 27 Clifton Terrace audit was quoted by the Post as calling P.I.'s accounts "by far the worst mess I'd ever seen." HUD Assistant Inspector General for Investigations, Paul Adams, when asked by the Post whether the auditors' discovery of missing records aroused any suspicion responded, "It's very unusual to have missing records, but this in itself is not cause for an investigation."

Shouldn't the fact situation in the Clifton Terrace case have at least raised a suspicion of possible fraud?

Mr. ESCHWEGE. Mr. Chairman, as you know, we established a GAO Task Force on Fraud and Abuse some time ago, and it is this group that is currently conducting a review of fraud and its causes in a number of Federal agencies, including HUD.

We are focusing on controls and procedures associated with the agencies detecting, reporting, and investigating fraud.

The effort is still in progress and we expect to have a report next year, probably in the second quarter.

Many of the entries, though, on the monthly financial statements do raise questions as to their propriety and probably should have raised questions, as I said earlier, by the auditors.

Senator PROXMIRE. Do you think it was an overstatement when one of the two auditors who conducted the Clifton Terrace audit, called P.I.'s accounts "by far the worst mess I'd every seen."

Would you characterize the accounts as a serious mess?

Mr. ESCHWEGE. As you know, we have not made a complete audit, but we do notice some irregularities on the face of the documents that we have been able to look at, and we do have very serious questions based on looking at the records that we have available.

Senator PROXMIRE. Shouldn't the discovery of the fact that records were gone, that there weren't any records, have triggered an immediate thorough investigation?

Mr. ESCHWEGE. I would say so. I think the first thing you would have to do is get someone in there—possibly, if you don't have the resources yourself, a reputable accounting firm—to reconstruct the records and get them in order so that a proper, complete audit can be made.

### ADVISABILITY OF INVESTIGATION

Senator PROXMIRE. The impression the staff has been left with in discussing the Clifton Terrace situation with HUD officials is that the auditors tend to look to the program people for guidance as to whether an investigation should be launched, while the program people are not inclined to request an investigation in the absence of an indication by the audit people that an investigation would be advisable.

In other words, it would seem that each group looks to the other for guidance. As a consequence, the situation breaks down and you don't get the kind of vigorous investigation and action that obviously seems to be required in a case like that.

Do you think this is a problem at HUD?

Mr. ESCHWEGE. Well, it certainly was a problem here to some extent. I think the HUD area office receives these reports and should review them and alert anyone, including the OIG, to the problems, so that they can come in.

It is also conceivable, while they don't have primary responsibility, that the OIG would go in on their own to at least selectively review some of the projects that they know are in trouble.

The OIG reports themselves have pointed out that HUD officials could do more in this area, in the area office, to monitor these reports when they come in, especially after they knew that the records were not in good shape.

### ACTIVITY OF INSPECTOR GENERAL

Senator PROXMIRE. I am all for an Inspector General. I think he performs a very important function. But in this case, I don't know what that Office was doing. It seems to me they didn't get into this until the newspapers began to expose it and complain about it, or at least until the reporters told the Inspector General about it. It wasn't reported in the press at that stage but the reporters are the ones who called it to the Inspector General's attention.

### HUD EXPENDITURES TO REHABILITATE CLIFTON TERRACE

How much has HUD spent rehabilitating Clifton Terrace?

Mr. ESCHWEGE. Here, too, we don't have any precise figures as to how much of the money went for rehabilitation. What we do know is, since HUD acquired the project in August 1978, HUD records indicate that about $600,000 has been spent on Clifton Terrace. But I hasten to add, there is no breakdown. Part of that, obviously, is for operating expenses. How much of this involves capital improvements, we don't know.

Senator PROXMIRE. You say HUD doesn't have detailed records. I think we ought to clear that up. Is it because the U.S. attorney has the records.

Mr. FULTZ. Partially, sir, yes. We did not obtain or review the records which would show the amount of money that has been spent for rehabilitation.

### CONDITION OF CLIFTON TERRACE WHEN ACQUIRED BY HUD

Senator PROXMIRE. Are there any estimates of the condition of the property when HUD acquired Clifton Terrace?

Mr. ESCHWEGE. Yes; there was a survey made of Clifton Terrace by HUD's management agent after the foreclosure and that indicated some major problems. For example, the roofs on the three buildings needed replacement. The air-conditioning, as was mentioned earlier, was not in working condition, and there was no insurance coverage of any sort. The fire alarm system and the fire extinguishers were not in working order.

### ESTIMATES OF REPAIR TO CLIFTON TERRACE

Senator PROXMIRE. Has any estimate been made of what it would take to repair Clifton Terrace?

Mr. ESCHWEGE. Yes; an architect-engineer made a report back in June of 1978 indicating that it would take over $1 million to repair the project.

Senator PROXMIRE. They sold this project for $800,000 in 1973, yet it would take more than $1 million to repair it?

Mr. ESCHWEGE. Yes.

Senator PROXMIRE. Were there any unique characteristics about P.I., Inc., that should have caused HUD to exercise precautionary measures in monitoring the Clifton Terrace project?

Mr. ESCHWEGE. I think so. P.I., Inc., was a nonprofit organization and historically nonprofit organizations have a higher failure rate. I am not saying HUD shouldn't make these projects available to nonprofit organizations, but it does require, when you do that, that you give them closer scrutiny.

The fact is that there was no financial interest in the property. HUD was willing to give this property a 100-percent mortgage, so there was no cash involved in this. Of course, later on there were serious management problems which surfaced in reports made by the area office and the OIG report and the fact that only four payments were made should have kept HUD completely involved in scrutinizing and making sure that the project——

### 100-PERCENT MORTGAGE

Senator PROXMIRE. You said there was no cash payment by the purchaser, it was a 100-percent mortgage.

Mr. ESCHWEGE. That is correct.

Senator PROXMIRE. A 100-percent mortgage means that the people who owned it didn't have anything at stake, really. They could walk away from the project without any loss at all.

Mr. ESCHWEGE. That is my impression; yes.

Senator PROXMIRE. What is the rationalization for that approach? How can it be sound?

Mr. ESCHWEGE. Well, I would assume that there are some nonprofit organizations who are very, very dedicated and are doing it for social reasons.

The incentive is not one of money, but one of just trying to do a good job.

Senator PROXMIRE. It is a matter, it seems to me, of the taxpayers' money being totally involved here so if the project suffers any loss at all, the taxpayers pay from the first nickel.

Mr. ESCHWEGE. That is correct.

Senator PROXMIRE. P.I. wasn't a church group.

Mr. ESCHWEGE. No.

Senator PROXMIRE. It was nonprofit in a sense. Maybe we will get into that a little later.

The impression we are left with in the Clifton Terrace situation is that one person at a high level within HUD—the Assistant Secretary for Housing or possibly the Secretary—has the final word regarding who buys HUD-held properties and can exercise this authority to summarily override the recommendations of operating personnel.

Doesn't this create the potential for questionable decisions, and wouldn't it make sense to require that the reasons for reversing a recommendation be documented?

Mr. ESCHWEGE. Well, of course, direct involvement of high-level HUD officials such as the Assistant Secretary or the Secretary in any given sale of acquired property is the exception rather than the rule. When such involvement does occur, whether that results in delays or questionable decisions is a matter we really haven't evaluated and we would have to look at it on a case-by-case basis. I do agree with you, Mr. Chairman, that when such involvement takes place, the files should clearly document why the decisions of lower level officials were overturned——

Senator PROXMIRE. I think that would be extremely important, because otherwise you have a situation where a top official can act arbitrarily. I would think for the protection of the official it would be a good idea. There is obviously a suspicion under those circumstances that some kind of pressure is involved. Consequently, the official in question should have good reasons and the reasons ought to be public and persuasive.

### STEPS TAKEN TO MAKE CLIFTON TERRACE LOAN CURRENT

From the time the Clifton Terrace mortgage was first assigned to HUD, what steps were taken to bring the loan current? Were any workout or modification agreements entered into?

Mr. ESCHWEGE. We are not aware, based on our discussions with agency officials, that there was any workout agreement reached. There are some indications there was talk about it, but that is all.

Senator PROXMIRE. Some indication of what?

Mr. ESCHWEGE. There was talk about having one.

We were told by these people, however, that there wasn't any agreement.

Senator PROXMIRE. What is the length of time a mortgage can be held by HUD without a workout agreement?

Mr. ESCHWEGE. There are some instructions, but they are not specific, as to how long a workout agreement can be made for. I guess it is done on a case-by-case basis.

Senator PROXMIRE. Do you think that is wise in view of your experience?

Mr. ESCHWEGE. Well, I would think you do have to examine the circumstances, and they are kind of different. I do feel, though, perhaps you could have a standard set as to how long you would like them to be and then have the HUD officials justify where they have to deviate from that standard.

I think they need some of that flexibility.

### MORTGAGE REQUIREMENT OF HUD

Senator PROXMIRE. What is the length of time a mortgage can be held without being brought current and foreclosure proceedings begun?

Mr. ESCHWEGE. Again, we couldn't find any specific reference to a limit beyond which a mortgage cannot be held without bringing about foreclosure.

Senator PROXMIRE. Once again, it would seem to me if a property in default was going to be held for any substantial period of time without the initiation of foreclosure proceedings, there ought to be reasons that are explicit and public as to why that is being done.

It is important to the protection of the taxpayer.

Mr. ESCHWEGE. I think that is correct.

Senator PROXMIRE. Have there been any disposition recommendations since the last Clifton Terrace foreclosure?

Mr. ESCHWEGE. We checked on this specifically with HUD officials and there has not been any recommendation made yet as to the disposal of the property.

### HUD RESALE OF CLIFTON TERRACE

Senator Proxmire. Do you know when HUD does expect to resell Clifton Terrace?

Mr. Eschwege. Of course, they are making plans to make the needed repairs now, and I assume they would want to complete that.

They told us in about a year they would be in a position to find a new owner.

Senator Proxmire. HUD sold the property for $800,000 after foreclosing on a mortgage which they insured and they apparently will make repairs for a million dollars and sell it again—it sure looks like a losing proposition for the taxpayer.

Mr. Eschwege. Of course, the earlier mortgage was for about $4 million.

Senator Proxmire. So they took a loss of $3.2 million on the $800,000 sale?

Mr. Eschwege. Yes.

### OTHER HUD-HELD PROPERTIES IN TROUBLE

Senator Proxmire. Mr. Eschwege, as you said in your opening statement, "HUD has great difficulty managing some 2,500 multifamily projects which it holds in its inventory or on assignment." I am deeply concerned over the possibility that there may be a great many more Clifton Terraces out there at the present time that we just don't know about.

Could you give us a report within the next 30 days on other HUD-held properties that are in deep trouble but have not been foreclosed?

Mr. Eschwege. You put a time limit on that of 30 days. We certainly would like to assist you as much as we can. Perhaps we can work out some kind of a scope of what we could reasonably do within the 30 days.

Senator Proxmire. See what you can do in 30 days and maybe we can get a further report in more detail.

Mr. Eschwege. We will be glad to do that.

### HUD EXPERIENCE FROM NATIONWIDE SCANDALS IN 1971-73

Senator Proxmire. Let me ask you whether HUD learned anything from the 1971–73 scandals in Detroit and many cities across the country?

Mr. Eschwege. I really am not sure I can answer that one. I think HUD will feel that they have. I think the programs have gotten much bigger and the defaults have gotten bigger. Perhaps it is not all HUD's fault. They have learned some things and they fixed some things, but then some different kinds of difficulties arise.

I must say that there are still major problems, as we pointed out in a series of our reports. We now have the section 8 projects and we see some problems with that and we still see problems with the old type of public housing projects as well.

Senator Proxmire. We go along with these housing projects year after year, but they are enormously expensive.

Of course, they serve a very vital social purpose. We all recognize we must provide housing for low-income people. At the same time, these are scandals I am talking about now, not the fundamental issue of whether we ought to provide housing more or less generously than we do. Here the issue is whether the gross errors that were made in 1971 through 1973 are being repeated. There doesn't seem to me much improvement over the years.

I think HUD has fine people. I have great admiration for the people who run HUD, but somehow either the organization is too big or the amounts involved are too great. We can't seem to eliminate these tragic failings that the programs have suffered. Clifton Terrace is a specific example and the fact is, as you told me, that three-quarters of the $3 billion in mortgages held by HUD across the country are delinquent—three-quarters.

Senator Mathias?

### HUD INVESTIGATION INTO CLIFTON TERRACE

Senator MATHIAS. Gentlemen, I just wondered what was the nature of your investigation and over what period of time you were able to look at this problem.

Mr. ESCHWEGE. Senator Mathias, as we point out in our statement, we did not make a complete investigation of Clifton Terrace. The records are now with the Department of Justice. However——

Senator MATHIAS. That is why I am wondering exactly what you did do.

Mr. ESCHWEGE. Yes; there were certain documents that were available to us, which HUD made available to us, as well as the Inspector General's report. I might add—and this is partly getting back to what Senator Proxmire said—that this is not the first time that GAO has been involved in reviewing multifamily projects that have been acquired or have been assigned. Back in 1974 we made a report and we came across some of the same things. For example, the monthly financial reports that were submitted to HUD were not looked at and discrepancies on the face of these reports were not reconciled.

We pointed out the many problems that were involved in maintaining these projects, and so on. So we had some general background. But this inquiry has been quite limited up to this point. We really tried to get at the facts of what took place, and we tried to get as many documents as we could to give a chronology of events and to show what the views of the different people within HUD were with respect to this project.

Senator MATHIAS. Are you telling the committee that what you detect is a pattern or practice which extends beyond Clifton Terrace?

Mr. ESCHWEGE. I am more concerned in this testimony with what happened in the case of Clifton Terrace.

As Senator Proxmire stated, we will see what we can do within the next 30 days to look at some of the other projects and find out whether there is this kind of pattern.

Senator MATHIAS. What do you anticipate doing by way of followup in this area, not only in the 30-day period, but in the longer range?

Mr. Eschwege. In the case of Clifton Terrace, there isn't much else we can do because the Justice Department is pursuing the matter and we have to let the Justice Department take its course and see what action it will take.

With respect to the general question of assigned properties we have other work on the way that I mentioned in the back part of my statement involving HUD's accounting systems for multifamily-assigned mortgages where we hope to have a report which is going to, again, deal with the monthly financial statements and how they can be utilized to alert people to problems that exist and also make sure that annual reports required are being submitted.

## REPORTS FROM INDEPENDENT PUBLIC ACCOUNTANTS

Senator Mathias. Those are what you referred to in your statement as the reports from independent public accountants?

Mr. Eschwege. Yes; those annual reports.

In the case of Clifton Terrace, of course, we didn't have those.

Senator Mathias. They were not commissioned by the Department?

Mr. Eschwege. Yes; there was some expression on the part of the Department that they should have them, but I believe the record shows there was negotiation with a public accounting firm but there never was an agreement entered into with the CPA firm to provide those kinds of statements.

Senator Mathias. Was there any reason given to you why an accounting was not ordered.

Mr. Fultz. The P.I. Property managers promised HUD that they were going to have an accounting firm perform an audit. We saw repeated statements that the audit was forthcoming but it just never occurred.

## COST TO PROPERTY MANAGERS OF AUDITS

Senator Mathias. At whose expense were the audits to be made?

Mr. Fultz. I believe it was at the expense of the managers. They are required to submit annual financial statements to HUD by a certified public accountant.

Senator Mathias. And the fact that they didn't do so was not followed up?

Mr. Fultz. That is right. It was part of the regulatory agreement that they were supposed to submit these records.

Mr. Eschwege. It was followed up to some extent. I guess you might say that maybe HUD wasn't insistent enough to make sure.

Senator Mathias. Is it an absolute requirement, is it mandatory, is it part of the whole scheme?

Mr. Fultz. Yes, it is.

Senator Mathias. And so, therefore, it would be a violation of the basic terms of the agreement?

Mr. Fultz. I would think so.

Senator Mathias. Thank you, Mr. Chairman.

Senator Proxmire. Thank you very much, gentlemen, for an excellent job. As always, the GAO does an outstanding job in accordance with your great tradition.

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# DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

## Office of Single Family Housing

## STATEMENT OF FRED W. PFAENDER, DIRECTOR, OFFICE OF SINGLE FAMILY HOUSING

### INTRODUCTION OF WITNESSES

Our final witnesses this morning are Mr. Fred Pfaender, currently the Director of HUD's Office of Single Family Housing in the central office, and Mr. Samuel C. Weisbach, who is currently retired, but formerly served as a HUD loan specialist.

I am particularly pleased you both could come before the committee and tell us about your roles in the Clifton Terrace case.

It is clear to me that you are two among a number of employees who raised the red flag early about problems at Clifton Terrace and we are glad to have you with us this morning.

Mr. Pfaender, why don't you present your statement first and then Mr. Weisbach can proceed.

Mr. Pfaender. Thank you, sir.

Mr. Chairman, my name is Fred W. Pfaender, and I reside in La-Plata, Md., and I am currently the Director of the Office of Single Family Housing in the central office of HUD.

With me this morning is Mr. Samuel Weisbach, a former employee of mine who is now retired but worked with me on the Clifton Terrace Apartments project at the time he was employed with HUD.

Mr. Wiesbach and I have arranged our statements to be as brief as possible and to avoid repetition. I will outline for you my involvement and actions in connection with Clifton Terrace Apartments.

While I retained some copies of key correspondence for my personal records, I have not reviewed the files and some of my statements are based on my recollection of the events. Copies of correspondence I retained should be in the HUD files.

### HUD JURISDICTION OF CLIFTON TERRACE

In June of 1975, I was Director of the Office of Loan Management at the central office of HUD which had jurisdiction over FHA multifamily mortgages held by HUD. Until June of 1975, I had no official connection with Clifton Terrace Apartments as the sale of the project was under the jurisdiction of the Office of Property Disposition.

With the closing of the sale in June 1975, the jurisdiction moved from the Office of Property Disposition to my Office as the sale involved HUD taking back a purchase money mortgage in the amount of $820,400. However, I was alerted as to the background of the sale by the Property Disposition staff and was verbally advised I could expect trouble. I, in turn, asked my staff to keep a close watch on developments. To the best of my recollection, we also asked the D.C. area office to closely track the case since they were responsible for overseeing day-to-day operations and monitoring the project.

On September 7, 1976, I wrote Mr. Harry Staller, the then Director of the D.C. area office, urging him to request a prompt audit and advised him that foreclosure might be the only alternative for Clifton Terrace.

On April 26, 1977, I wrote Mr. Larry Simons, the Assistant Secretary for Housing/FHA Commissioner, that the D.C. area office had advised me that the Washington Post would probably carry a story on Clifton Terrace within a few days.

I also advised Mr. Simons that we were suspicious that the owner/management agent was misusing project funds but an audit had been completed by the Philadelphia regional inspector general and we were expecting an interim audit report to be available in about a week.

In the April 26, 1977, memorandum I also gave Mr. Simons the historical background of the case and pointed out only four payments had been received by HUD with the total delinquencies being $182,027 at April 1, 1977, on the $820,400 mortgage.

### RECOMMENDATION OF AUDIT

On May 9, 1977, I advised Mr. Simons that the Washington Post had not yet carried any story and also summarized for him the findings of the audit report and the recommendations of the auditors. The auditors had recommended: One, the owner correct deficiencies in the accounting system; two, we consider changing the managing agent; and three, we request the owners to make arrangements for bringing the mortgage current.

I also advised Mr. Simons that we were awaiting the recommendation of the D.C. area office that would follow the final audit report. Since I had handled many audit reports on multifamily projects during my career and considered the auditors as being very tough, detailed, and hard in their recommendations, I was personally very disappointed in that particular audit report in view of my knowledge of the case. To the best of my recollection, it was about this time I asked Mr. Weisbach to prepare what we termed a spread sheet.

### SPREAD SHEET

Senator PROXMIRE. Let me interrupt to ask you to explain the term "spread sheet"?

Mr. PFAENDER. Sir, that was a sheet that Mr. Weisbach and I tried to prepare to graphically describe what the project was doing with the income.

On June 20, 1977, Mr. Clay wrote me and recommended immediate foreclosure. On June 24, 1977, we prepared a memorandum for Mr. Simons to Secretary Harris giving some background on Clifton Terrace, the results of the audit report, and reported that HUD had advanced $80,434 to pay the mortgagor's real estate taxes and water and sewer charges because of the lack of payments flowing to HUD and that PEPCO had discontinued service to the project for 2 hours with the D.C. Government paying $91,000 to restore the service. We also pointed out that HUD would probably have to pay the D.C. Government the $91,000 since the D.C. Government would create a prior lien on our mortgage and that the mortgage delinquencies were $203,800 as of June 1, 1977.

The memorandum advised the Secretary that Mr. Clay had recommended foreclosure and gave two other options that would remove P.I. Properties, Inc., from control of the property.

On August 3, 1977, Mr. Clay wrote to Mr. Simons officially requesting that his June 20, 1977, recommendation for foreclosure be held in abeyance while he undertook activities to cure the mortgage default and clear the audit findings. On August 15, 1977, I furnished my new superior, Ms. Marilyn Melkonian, copies of the previous papers and advised her that Secretary Harris had evidently met with Mr. Clay and negotiations with the sponsor had been renewed.

We mentioned that the attached papers would reflect the consequences of past mismanagement and the effect on the low- and moderate-income tenants. I also advised Ms. Melkonian that Mr. Joseph Burstein, Special Counselor to the Secretary, was acting on the Secretary's behalf on Clifton Terrace and other troubled D.C. projects.

To the best of my recollection, it was after my August 15 memorandum to Ms. Melkonian that she indicated to me that she would handle the case personally and would use Mr. Donald Myers, my HUD-Held Division Director, for what matters she needed from my Office.

While I may have signed some later letters, as directed, and attended a few meetings, for all practical purposes my involvement with Clifton Terrace ended at that point.

Senator PROXMIRE. Thank you, sir.

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## NONDEPARTMENTAL WITNESSES

### STATEMENT OF SAMUEL C. WEISBACH, FORMER HUD LOAN SPECIALIST (RETIRED), OFFICE OF LOAN MANAGEMENT

Senator PROXMIRE. Mr. Weisbach?

Mr. WEISBACH. Thank you, Mr. Chairman.

My name is Samuel C. Weisbach. I live at 9900 Georgia Avenue, Silver Spring, Md.

From May of 1975 until my retirement from HUD in May of 1978 I was employed as a loan specialist in the Office of Loan Management dealing exclusively with the servicing of mortgages held by the Secretary. Sometime in the fall of 1975, I was assigned to monitor the servicing of mortgages on projects located in region III, including the mortgage on Clifton Terrace Apartments which was under the jurisdiction of the District of Columbia area office.

The terms of the mortgage and regulatory agreement provided for payments of a service charge and tax accruals beginning July 1, 1975, with installments of interest, principal, and reserve for replacements deposits commencing on January 1, 1976.

I am speaking mainly from memory inasmuch as I have not had access to the files and records pertinent to the Clifton Terrace project.

As the mortgage delinquency steadily accumulated during the first half of 1976, I spoke on many occasions to the D.C. area office servicer about the serious default, but was unable to obtain explicit recommendations for future servicing action. Our concern over the ever-worsening condition of the mortgage account precipitated the September 7, 1976, memorandum to Harry Staller, Director of the District of Columbia area office, outlining the owner's payment record and strongly urging a prompt audit of the mortgagor's operations.

#### HUD IG AUDIT OF CLIFTON TERRACE BOOKS

We also indicated to Mr. Staller that foreclosure might be the only alternative unless a viable operation could be sustained. It was then that the HUD Inspector General was asked to audit the books of Clifton Terrace.

Mr. Pfaender has told you about our memoranda to the Assistant Secretary for Housing concerning the status of the mortgage, the conditions of the project, and the findings of the IG's audit.

I believe it was on a Friday in late spring of 1977 that Mr. Pfaender received a package of monthly accounting reports repared by P.I. Properties, Inc., covering approximately 5 or 6 months of project operations. Each monthly accounting contained schedules of receipts, disbursements, and accounts payable. He asked me to review the accountings and report to him the following Monday morning.

Over the weekend, I prepared a spread sheet categorizing the income and disbursements. While I cannot be specific, I do remember a substantial amount of project income was used to pay bank loans and to repay loans made by employees of P.I. Properties to the project. Other expenditures appeared to be inordinately high.

When a mortgage is in default, the owner is not permitted to pay loans from project income without the prior approval of HUD.

### FORECLOSURE RECOMMENDATION

When I saw Mr. Pfaender Monday morning, it seemed obvious to him, as it was to me, that project income had been diverted improperly. That afternoon, Mr. Pfaender and I met with Mr. Simons in his office to show him the spread sheet and discuss the Clifton Terrace case. After our discussion, Mr. Simons said he would see "Pat" that evening and recommend we foreclose.

After the memo of August 15, 1977, to Marilyn Melkonian reporting Director James Clay's reversal of his earlier foreclosure recommendation, I was informed by my immediate supervisor, Donald Myers, Director, HUD-Held Multifamily Mortgage Division, that Ms. Melkonian had assigned him to personally handle all matters on her behalf pertaining to Clifton Terrace.

Thereafter, I had no direct involvement in any matters relating to this project mortgage.

Thank you.

Senator PROXMIRE. Gentlemen, I want to thank you very, very much. It is not easy to do what you are doing this morning. I know it takes courage. I think you deserve the highest kind of commendation for coming forward as you have and we are in your debt.

Senator MATHIAS. I might observe, Mr. Chairman, that they live in Maryland. You wouldn't expect any less.

Senator PROXMIRE. "Maryland, My Maryland." That's right.

Your Senator, Senator Mathias, demonstrates that kind of civic concern and conscience to us in the Senate on many occasions.

### WARNED TO EXPECT TROUBLE

Mr. Pfaender, in your prepared statement, you say, "Until June of 1975," you had no official connection with Clifton Terrace, since the sale of the project was under the jurisdiction of the Office of Property Disposition under the direction of Mr. William Cameron. You go on to say that once the sale of Clifton Terrace to P.I. Properties was consummated in June of 1975, you were "verbally advised by the Property Disposition staff that you could expect trouble."

I was a little shocked when I saw that statement that, "you could expect trouble." What do you mean by that? Was there an indication that you would be subjected to some kind of pressure or what?

Mr. PFAENDER. No, sir; I did not mean it in that sense. In the many discussions with the Property Disposition staff, they were telling me that the sale was an optional purchase with a trial period by P.I. Properties, that P.I. Properties was in possession of the property as managing agent during a trial period. The staff was telling me that the trial in their view was not at all successful, but it looked like the sale was going to move ahead, so they were saying I could expect trouble with the owner and managing agent because they were having trouble during the trial period.

Senator PROXMIRE. I wanted to be sure I understood that statement fully. Did it mean you could expect trouble with respect to the particular problems here and thus was not a personal threat of any kind?

Mr. PFAENDER. No, sir. In addition to what I was saying, the trial period was set up because there was no mortgage at that point, to see what income would flow. In other words, P.I. Properties was in there as managing agent collecting the income and paying the expenses. It was more or less a test to see what excess income would come into HUD and to see if the project would support a mortgage. They, in effect, were telling me they were not getting any payments in that period that looked like they would support any mortgage.

### NEGOTIATED SALES

Senator PROXMIRE. The subcommittee understands that a trial management period followed by a sale to the management firm was unique to the Clifton Terrace situation. Are you aware of any other projects that followed this route?

Mr. PFAENDER. Sir, that was a negotiated sale. I believe after that, bearing in mind this was not in my area, there were some negotiated sales.

The Property Disposition Division, I think, did negotiate some tenant co-ops, when they sold to a cooperative or possibly to a city. Whether there were any other negotiated sales with a 100-percent mortgage being attached to a community-based organization, I am not certain. It would not have been in my area.

### MEMO URGES PROMPT AUDIT

Senator PROXMIRE. Mr. Pfaender, on September 7, 1976, you sent a memorandum to Harry Staller, who was then Director of HUD's Washington area office, in which you said: "In reviewing the payment record of the mortgagor since closing of the sale, I can only conclude that the operation is heading for disaster unless some stringent servicing is accomplished."

You pointed out that a June 4, 1976, check for over $10,000 had bounced and that $106,151.47 was immediately due and owing under the deed of trust and regulatory agreement.

You then went on to say: "If the mortgage default has been precipitated by mismanagement resulting in improper and/or inflated expenditures, which drained income that would have been available for debt service payments, I would strongly urge you to request a prompt audit of the mortgagor's operations."

What was the response to this memorandum?

Mr. PFAENDER. Sir, since I don't have the files, I don't recall the written response except the field office did request an audit because there was one made and it was completed in May of 1977.

Senator PROXMIRE. The audit was made? When was the audit commenced?

Mr. PFAENDER. As near as I remember, as a result of my September 1976 memo, they did put in a request for the IG to go in and make an audit. It usually takes the IG a period of some months. But I just can't tell when they did request it without the files.

Senator PROXMIRE. Would you regard that audit as a reasonably prompt response to your memorandum?

Mr. PFAENDER. Yes. In fact this was a tip-off, in bureaucratic jargon, to the field office to get an audit because the head office was suspicious.

Senator PROXMIRE. Mr. Pfaender, in a memorandum to Assistant Secretary Simons, dated April 26, 1977, you pointed out that "the Secretary-held mortgage has been in a serious state of default for many months" and that "there is . . . a suspicion that owner/management may have misused project income."

The memorandum from William Brown accompanying the May 27, 1977, audit criticized the area office for "not fully utilizing monthly financial reports submitted by the project officials" and went on to say that "prior to commencing the project audit, your staff pointed out many irregularities involving project costs as shown on the monthly disbursement statements."

### DISAPPOINTING AUDIT REPORT

In view of these implications that something was seriously amiss at Clifton Terrace your statement that you were "personally very disappointed" in the audit report seems warranted. Could you elaborate on your reaction? What would you have expected to be in the audit report?

Mr. PFAENDER. Sir, having looked at almost all audits that were coming through on the multifamily projects, I expected to see a detailed check-by-check rundown on how the expenditures were improper. What I was really expecting on that case was a recommendation from the auditors that we immediately refer it over to the Department of Justice.

On the audits I was used to, the auditors would make a very detailed report, check-by-check, and would go into the books deeper than either our Office or the field office could. It is just not generally the type of report I was expecting. Probably the more surprising thing—because in the audit report they were pointing out what we thought would happen—the recommendations were probably the strangest part of the audit.

Senator PROXMIRE. How can you explain that? Why didn't they provide the kind of audit that you would normally expect in circumstances like this?

Mr. PFAENDER. Unfortunately, sir, I am unable to answer that.

Senator PROXMIRE. You weren't born yesterday. You have been serving our Government for some time. You are obviously a man of great integrity. The fact you are here today, I think, shows that.

What would be your conclusion? What would be a logical conclusion for any reasonable person to come to?

Mr. PFAENDER. Sir, I thought at that point, because I have the utmost respect for Mr Dempsey, the IG—that the audit probably went out of the Philadelphia regional office and, to be honest with you, I just thought they blew it.

Senator PROXMIRE. It is just a matter of not taking the job seriously enough or not doing a good job.

Mr. PFAENDER. From my knowledge of the case, I thought they would probably run into trouble. Still, with those problems, they could still make a much more detailed audit.

Senator PROXMIRE. Was there any indication at all that they were under pressure not to perform a detailed audit?

Mr. PFAENDER. Not that I know of, sir. I might mention that, unlike my operations, the IG reports straight to the Secretary. They are not subject to the guidance or under the authority of the program officers. I look at them as a very independent, tough reporting outfit. Like I say, most of their audits would help us.

I was also expecting that, as you can see from the subsequent mess, the audit would probably have things in it that would put to bed the decision as to whether we should go ahead with foreclosure or not, that it would back up our request for immediate foreclosure, from the administrative standpoint of what we should do. So I was also surprised regarding the extent of their recommendations.

Senator PROXMIRE. Isn't there normally a recourse under those circumstances? Could you go to the Secretary, to the Inspector General, or to other people who were your superiors in the Department, ask that they take another look at this very bad situation, and say, "I think it deserves much more scrutiny than we have given it"?

Mr. PFAENDER. One could request that the auditors go back out again, but I don't recall any instances where you basically criticize an audit report.

Senator PROXMIRE. Why not? Why wouldn't that be a healthy thing?

Mr. PFAENDER. I can tell you in bureaucratic jargon that the program officials were very slow to criticize the IG, that we discussed amongst ourselves——

Senator PROXMIRE. Why shouldn't they be willing to criticize? Wouldn't it be a good thing if they were?

Mr. PFAENDER. It probably would be; yes.

Senator PROXMIRE. But when you got this kind of disappointing response, you felt at that time, and presumably you feel now, that there was not much you can do, you just had to accept it as part of the system.

## AUDITORS USUALLY TOO TOUGH

Mr. PFAENDER. I don't want to mislead you. We did comment on many audit reports. Usually it was the other way around. We complained that the auditors were too tough. That is why it is difficult to tell you. As you heard the gentleman from GAO say, there are some clean cases where, from the general standpoint, you see that the owners are operating fairly, and so forth. All my general experience was that the auditors would pick out one check on a clean operation and say they threw a $40 party for the employees and you program people should be certain to get that $40 bucks back, and so on, and so forth. Then we would write to say it was the other way around, saying they were too tough on their recommendations.

Senator PROXMIRE. But in this case, they said the owner was spending money on business parties for the tenants but didn't pick up any of the really serious abuses.

Mr. PFAENDER. The audit was not as detailed as I thought it would be.

Senator PROXMIRE. That is a massive piece of understatement.

Mr. PFAENDER. It was one reason why, rather than going back to the auditors and trying to get another audit, about that time I said to Mr. Weisbach, "Let's do it ourselves," and asked him to take the monthly accountings and make up this spread sheet, which is a graphic display of where the money is going to.

Senator PROXMIRE. I certainly would like to get some kind of a recommendation on what we can do in the future to make it possible for people like you who recognize an audit isn't adequate to have some way of making an effective complaint and getting the kind of action you need to get, or at least have some recourse. You apparently felt under the circumstances—and this is certainly no reflection on you at all, I am sure your judgment is good—that it would be hopeless for you to make any kind of appeal; is that right?

Mr. PFAENDER. That is correct, sir.

Senator PROXMIRE. Maybe for the record you could reflect on this and suggest what we might do to improve the situation so we don't have that kind of paralysis in the future.

### P.I.'S MONTHLY ACCOUNTING REPORTS

Mr. Weisbach, in your statement you indicate in the late spring of 1977 Mr. Pfaender asked you to go over a package of monthly accounting reports prepared by P.I. Properties, covering approximately 5 or 6 months of project operations and to report back to him with your findings. Apparently, you found in one weekend what HUD's auditors were unable to find over a period of 2 months; that is, that project income was used to pay bank loans and to repay loans made by employees of P.I. Properties to Clifton Terrace at a time when the project was deeply in arrears on its mortgage payments, and the apparently improper diversion of funds.

In your opinion as a career auditor, shouldn't a large number of these and other irregularities have been picked up by the region III audit team and reported in detail in its May 27 report, and shouldn't this type of audit finding have prompted HUD to go to the next logical step and ask for a further investigation?

Mr. WEISBACH. Senator Proxmire, I want to put that in proper perspective. These accounting reports that Mr. Pfaender received were prepared by the owner-managers themselves, and were available, to my knowledge, in the HUD area office. We had received this package of accountings in the central office and I see no reason why they wouldn't have alerted the auditors to go into this situation more thoroughly.

Senator PROXMIRE. They knew it. They had the information available. You say they just didn't follow up on that information.

Mr. WEISBACH. I am assuming so, Senator Proxmire, because I have no way of knowing exactly what the auditors did and how they conducted their audit.

### RENEWED NEGOTIATIONS

Senator PROXMIRE. Mr. Pfaender, in a memorandum to Deputy Assistant Secretary Melkonian, dated August 15, 1977, you wrote:

> I understand that Director Clay met with Secretary Harris shortly after making his foreclosure recommendation to me on June 20, 1977. Apparently, that meeting resulted in renewed negotiations with the sponsor.

This statement implies that the primary reason a Clifton Terrace foreclosure was delayed for 13 months—that is, from July of 1977 to August of 1978—was a decision by Secretary Harris that an attempt should be made to work things out. Is this the case and do you have any knowledge of the factors that might have played a part in this decision?

Mr. PFAENDER. No, sir. At that point, all I knew was we had the memorandum up to the Secretary and within HUD we were awaiting a decision from the Secretary as to whether to go ahead and foreclose or to pick one of the other two options that we had run up there, when word suddenly came over—I believe it was from the D.C. area office lower staff people—that Director Clay had met with the Secretary and we would be receiving a withdrawal of the foreclosure recommendation from Mr. Clay. I did not know any details of that meeting or anything about it until I read the Washington Post.

Senator PROXMIRE. As far as you know, was there any formal, detailed response submitted by Secretary Harris, or by Mr. Clay, to justify the reversal of the earlier foreclosure recommendations and, if not, wouldn't it make sense to establish a systematic signoff procedure at HUD before a foreclosure decision is overruled out of hand?

Mr. PFAENDER. Mr. Clay, on August 3, 1977——

Senator PROXMIRE. August 3 of 1977?

Mr. PFAENDER. Yes. He wrote back saying why he was going to withhold the foreclosure. I think he termed it "hold the foreclosure action in abeyance, I am going to renew negotiations." The memorandum mentioned his reasons for that request that we hold it in abeyance.

Senator PROXMIRE. That is not really a formal detailed response by the Secretary.

Mr. PFAENDER. No, sir; it was just a one-page memorandum saying, "Hold off," which gave a few reasons.

Senator PROXMIRE. My question is, Wouldn't it make sense to establish a systematic signoff with the reasons set forth in some detail?

Mr. PFAENDER. Yes, sir.

### INVOLVEMENT IN CASE TERMINATED

Senator PROXMIRE. Mr. Pfaender, according to your testimony, shortly after your August 15, 1977, memo to Deputy Assistant Secretary Marilyn Melkonian, she indicated to you that you were off the case and that she would now handle the Clifton Terrace case personally with assistance from your subordinate, Mr. Donald Myers—your HUD-Held

Properties Division Director. In other words, for all practical purposes, your direct involvement in Clifton Terrace ended in mid-August of 1977.

Mr. PFAENDER. Yes; that is correct.

I might be a little off on the date.

Senator PROXMIRE. It seems rather odd to me that the Director of the Office of Loan Management, who had been directly involved in reviewing P.I.'s performance since the sale of the project in June, would be "benched" at a time when the condition of P.I. and the project were at a most critical stage and finally getting intense scrutiny from the central office.

What specific reasons did Ms. Melkonian give for removing you from the Clifton Terrace case in August of 1977 and turning instead to your subordinate, Donald Myers?

Mr. PFAENDER. Again, without the files—I am pretty certain nothing is in writing—but to the best of my recollection Marilyn said the Secretary was personally interested in the case—Marilyn might have wanted to impress the Secretary; she was relatively new at that time—so she would go ahead and handle everything personally.

Senator PROXMIRE. That raises quite a question. It is hard for me to come to any conclusion except that you were removed from the case because you felt it needed more thorough and careful investigation and that you were taking a tough line. Is that unfair?

Mr. PFAENDER. It may be unfair to Ms. Melkonian because I had a reputation of being very hardnosed, very fiscally prudent.

Senator PROXMIRE. All of which are great attributes.

Senator MATHIAS. It won't hurt you with the chairman.

Senator PROXMIRE. You won't get a Golden Fleece award.

Mr. PFAENDER. I think Melkonian thought I wasn't socially conscious. I think her term for me was I was to the right of Genghis Khan. I looked at it as a difference in philosophy. It was also well known I had no alternatives to offer in the verbal discussions. I was just saying we should move for foreclosure right away and try to get control——

### FORECLOSURE WOULD HAVE AIDED TENANTS

Senator PROXMIRE. I want to make sure I understand this. The foreclosure would not have removed the tenants, would it?

Mr. PFAENDER. No, sir.

Senator PROXMIRE. It wouldn't have had any perverse or adverse effect on them. What it would do is remove the management.

Mr. PFAENDER. Yes; I think the tenants would have been helped.

Senator PROXMIRE. Would have been helped?

Mr. PFAENDER. Yes.

Senator PROXMIRE. The tenants wanted it?

Mr. PFAENDER. I thought we could do a better job if we were in control. With a recommendation for foreclosure, we could ask the court that we be put in as mortgagee in possession while the court action proceeded.

My recommendation was verbally, "Go ahead and foreclose," and, if it looked like we would be held up in the courts, request the court be put in control as mortgagee.

Senator PROXMIRE. What would be the argument for not foreclosing and continuing in view of this long record?

Mr. PFAENDER. I would be second-guessing others. I don't really know.

Senator PROXMIRE. Senator Mathias?

Senator MATHIAS. Mr. Chairman, I have no questions. I will join you in thanking these gentlemen for coming forward with their testimony today, which hasn't been easy. It seems to me the hearing today has raised at least two questions. One goes to the procedures within HUD by which all questions of this sort are handled. That is, of course, the question which the GAO will be reporting back to the committee on at a later date under your instruction. Second, I am concerned for what the future holds for the tenants in this particular situation, what their condition is, what sort of bind they are finding themselves in now and are likely to find themselves in in the future.

Senator PROXMIRE. Earlier in the hearing, Senator, the tenants made a very clear, emphatic, detailed plea for conversion to a cooperative. I thought it was an impressive appeal.

They indicated that they certainly have suffered, in their judgment, under P.I.'s management.

The witnesses appearing before the subcommittee today have set forth an abysmal record of delay and neglect in the handling of the Clifton Terrace project. As I indicated in my opening statement, I'm very concerned over the possibility that there may be other Clifton Terraces in HUD's inventory. This subcommittee appropriated $195 million to the FHA fund for fiscal 1980 to cover the fund's losses.

The taxpayers may have to pay a much steeper bill in the years ahead if HUD's performance in this case is the rule and not the exception.

In any event, we will be hearing the Department's side of the story in early December when Secretary Landrieu will appear. By that time we may have information from the General Accounting Office regarding other HUD-held projects that are in deep trouble.

I want to thank you gentlemen once again for your appearance. As Senator Mathias said so well, it can't be easy. It certainly isn't something you wanted to do, but you have served a necessary purpose.

### SUBCOMMITTEE RECESS

The subcommittee will stand in recess until December 5, when we will hear from officials of the Department of Housing and Urban Development.

[Whereupon, at 12:02 p.m. Tuesday, November 13, the subcommittee was recessed to reconvene on December 5.]

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# MANAGEMENT OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT'S INVENTORY OF MULTIFAMILY PROPERTIES

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WEDNESDAY, DECEMBER 5, 1979

U.S. Senate,
Subcommittee on HUD-Independent Agencies,
Committee on Appropriations,
*Washington, D.C.*

The subcommittee met at 10:02 a.m., in room 1318, Everett McKinley Dirksen Senate Office Building, Hon. William Proxmire (chairman) presiding.

Present: Senators Proxmire, Leahy, and Bellmon.

## DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

### OPENING STATEMENT OF SENATOR PROXMIRE

Senator Proxmire. The subcommittee will come to order.

I am going to take a little more time than usual with the opening statement because I think we confront an unusual kind of situation today that needs some explanation.

We will hear this morning from officials of the Department of Housing and Urban Development regarding the Department's record in handling Clifton Terrace, a HUD-held property that was first managed and then purchased by P.I. Properties, Inc., of Washington, D.C. According to press accounts, P.I. Properties systematically milked the project at the cost of the American taxpayer, while making only four mortgage payments in 3½ years.

### OUTLINE OF EVENTS

Let me briefly outline the events as they occurred in the Clifton Terrace case.

On March 15, 1974, H. R. Crawford, then a HUD Assistant Secretary, instructed the District of Columbia area office to reject any bids to manage Clifton Terrace because he wanted to negotiate the deal himself.

In April of 1974, Pride International took over the management of Clifton Terrace.

On May 16, 1974, a draft agreement to sell Clifton Terrace to a newly formed nonprofit corporation, P.I. Properties, Inc., for $1.3 million after a 6-month trial management period was signed.

On June 30, 1975, after paying $93,566 in utility bills, HUD sold Clifton Terrace to P.I. Properties at a reduced price of $820,400 financed by a 100-percent Secretary-held mortgage with a 6-month moratorium on mortgage payments.

In February of 1977, after requesting the remittance of $149,651 due and owing, HUD initiated an audit of the project.

A HUD audit report was issued on May 27, 1977. The summary indicated the books were so inadequate that a comprehensive audit could not be conducted and contained a number of recommendations for further action.

On June 27, 1977, a recommendation of foreclosure by Area Director James Clay was forwarded by Assistant Secretary Simons to Secretary Harris. At that time, the mortgage default totaled $203,800 and electric power to the project had been discontinued briefly because of delinquent utility bills of $91,000.

On August 3, 1977, a memorandum from Area Director Clay to Assistant Secretary Simons officially requested that the foreclosure request be held in abeyance.

On June 26, 1978, HUD initiated foreclosure proceedings.

On August 23, 1978, HUD acquired Clifton Terrace once more at a foreclosure auction.

Unfortunately there is a great deal to criticize in the way the Department has dealt with the Clifton Terrace project. Three questions in particular loom large in any consideration of the way the project was handled. They are:

First, why was Clifton Terrace sold to P.I. Properties, Inc., following a trial period which made it clear that the organization was unable to properly manage the project?

Second, why were obvious improprieties not detected by the May 27, 1977, audit?

Third, why did HUD delay for 1 year in foreclosing on P.I. Properties despite the strongest kind of evidence that the project was being mishandled?

It would be understandable if HUD's failure to act in the Clifton Terrace case were attributable to an excess of zeal in protecting the interests of the tenants. But we have heard from the tenants and they have told us that their interests were ignored by the Department and P.I., Inc.

It would be understandable if HUD's failure to act were attributable to a lack of knowledge regarding the extent to which the project was being milked by the owners. But as early as September 7, 1976, the Office of Loan Management referred to the operation as "heading for disaster unless some stringent servicing is accomplished," a memo to Assistant Secretary Simons dated April 26, 1977, pointed out that the owner/managers "may have misused project income," and the May 27, 1977, audit report overlooked clear evidence that was readily available to HUD that improper transactions were taking place.

It would be understandable if HUD's failure to act were due to inadequate staffing. But if this project suffered from any staffing problem it suffered from a surplus of staffing. Too many cooks were stirring the broth.

It would even be understandable if this project were an exceptional case—the one rotten apple in an otherwise sound barrel. However, although we won't be looking at other projects until next month, every indication is that Clifton Terrace is a symptom of deeply rooted neglect and mismanagement that pervades the inventory of HUD-held multifamily properties.

I visited Clifton Terrace on Saturday, November 3—over 1 year after HUD had foreclosed on P.I., Inc. What I saw was a building with 40 vacant, burned-out apartments that had been in that condition for over 2 years, units that were suffering from water damage because of leaking roofs in addition to the ones that were burned out, and a front door without a glass pane, so that anyone could walk in off the street without a key.

Here we have an apartment complex within sight of the Nation's Capitol. HUD has spent almost $6 million on the project yet it is in deplorable shape. There seems to be clear evidence that the project was systematically milked by its last owner.

Warning flags were going up as early as mid-1975, yet HUD did not move to foreclose until June 26, 1978, 3 years later. The victims of this bureaucratic delay were the taxpayers, whose money was squandered, and the tenants, whose wishes were ignored.

Today we will try to find out how this series of events could have happened. In January, we will take a look at other troubled projects and explore what might be done to improve HUD's performance in the handling of its multifamily inventory.

I would also like to read, before I call on Senator Leahy and today's witnesses, a letter which I received from former Secretary of HUD, Patricia Harris. It's a brief letter and I will read it in its entirety. It was dated yesterday:

> I regret that you have refused to allow me to testify before the subcommittee on December 5, 1979, on questions relating to management policies and practices during my tenure as Secretary of Housing and Urban Development.
>
> I assume that your decision that my presence is not necessary at this hearing will mean that there will be by you no repetition of the suggestions of misconduct or impropriety on my part that were characteristic of your line of questioning at the committee hearings on November 13.
>
> I take strong exception to the innuendo and attempted character assassination contained in the first subcommittee hearing record, and I can only assume that your refusal to permit me to testify on the 5th means that there will be no repetition of efforts to suggest that I, in any way, behaved improperly on the matter of Clifton Terrace. In case there is any doubt in your mind, I gave no orders of any kind to Mr. Clay, or anyone else, to do anything with respect to Clifton Terrace except to protect the interest of the Government and honor its obligations, and protect the tenants and the community.
>
> Attached is a copy of the testimony I would have delivered if I had been given the opportunity to appear before the subcommittee. I request that this letter and this statement be included in the official record of these proceedings.

I am going to read from the testimony, too, because it is excellent testimony. It is very helpful to us. Mrs. Harris is an extraordinarily intelligent and able person. She makes a fine analysis of the problems that HUD has had in connection with managing properties and with public housing generally. I think everyone would find the testimony well worth reading.

Although I apologize for delaying the committee's proceedings, at this time I particularly want to call attention to several parts of Secretary Harris' statement because it relates so directly to what we are considering today.

The prepared statement says, in part:

> We did not accomplish everything we set out to do, but we did put in place the foundation upon which a better management structure can be built in the months and years ahead. Accomplishing that task will be much more difficult if the positive strides made by this administration and the Congress are not given time to take effect. Specifically, if this body focuses public attention on the past policy failures—failures which we all recognized 2½ years ago, failures which we have been trying to correct—and fails to portray accurately the Government's response to correct these conditions, it will do a serious disservice to the many people in HUD, in the administration, in this body, and across the country who are trying to make the housing programs work effectively for the people they were intended to serve. Furthermore, unless there is a clear public perception—as there was with the enactment of the flexible subsidy program—that the Congress and the administration are working together to solve these complex policy questions, I doubt that we can maintain the broad-based support for these efforts and all of the Federal housing programs in the years ahead.

The Secretary's statement then concludes as follows:

> I would like to address another issue. It is my understanding that the committee will use today's session to probe the Department's handling of Clifton Terrace. Assistant Secretary Simons has informed me that he is prepared to present the Department's record in terms of the specifics on that matter.
>
> Before he does, I would like to say the following about Clifton Terrace. At no time did I or anyone working for me instruct any employee of HUD to change policy recommendations made about that project. When decisions were made by me to change policies or specific recommendations, such changes were made on the record. If there is no record of instructions to change policy on any matter that was brought to me, it is because no such instructions were given on Clifton Terrace or any other matter.
>
> Neither I nor any employee acting on my behalf instructed HUD career employees to make any decisions or do any act other than those dictated by the responsibilities of their office and their oath of office. Innuendoes or suggestions to the contrary are false.
>
> In an almost tragic way, the entire saga of Clifton Terrace portrays just how difficult it can be to make troubled projects work for the community of which they are part.
>
> It would be a form of McCarthyism—

This refers to Senator Joe McCarthy's way of proceeding in the Senate.

> at its worst if the Government, and the many individuals who acted in good faith, were to be held accountable for the irresponsibility and the alleged illegal actions of the owners of Clifton Terrace. If there was impropriety or criminal behavior at Clifton Terrace between January 21, 1977, and August 3, 1979, none of it was related in any way to the Secretary of Housing and Urban Development, her staff, or the Assistant Secretary for Housing or the Deputy Assistant Secretary.

In light of those statements, let me just conclude my opening remarks by answering the question as to why we didn't invite Secretary Harris to testify. First, I want to make it clear that I voted against Secretary Harris' confirmation as Secretary of HUD as I have opposed other Presidential nominations in the past, and as I will in the future when I think we could have more competent people. But in the case of Secretary Harris, I was wrong, and I am in a strong position to know that.

I served as chairman of both the Banking Committee, which has the principal authorizing responsibilities for HUD, and as chairman of this appropriations subcommittee which has the prime funding responsibility for HUD. Nobody in the Congress was in a better position to judge Mrs. Harris during her entire stewardship of HUD than was I.

My judgment was this: She was an honest and competent Secretary. She hired a first-class team of subordinates. Her integrity, as well as her competence, is unquestioned.

At the previous hearing, there were only one or two questions in the 2 hours of testimony in any way involving Secretary Harris. In my judgment there was no significant reflection on her integrity or competence. So I have respect for Mrs. Harris and the efforts she made to deal with the problems she found upon becoming Secretary of Housing and Urban Development.

I also have respect for former Secretaries Lynn and Hills who served at HUD during the period that Clifton Terrace was first managed and bought by P.I. Properties. Serious mistakes of judgment occurred under all three Secretaries, but those mistakes cannot be laid at the door of any one individual or group of individuals. They represent a breakdown in the system of handling HUD-held properties.

This is a congressional subcommittee. It is not a historical society, nor a newspaper, nor a court. So we are not inviting Secretaries Lynn, Hills, or Harris, or Mary Treadwell. We are not trying to point the finger. We are trying to discover what we can learn from the Clifton Terrace experience about HUD-managed properties and how we can improve that management in the future.

For these reasons, we have asked the present Secretary of Housing and Urban Development, Hon. Moon Landrieu, to appear and bring with him the HUD team led by Assistant Secretary Simons, who has from his own experience the greatest familiarity with the Clifton Terrace problem.

I am confident Secretaries Landrieu and Simons have the competence, and with the support of the President and the Congress, the authority and ability to move vigorously to correct this situation. That is what we are anxious to do.

### HARRIS' STATEMENT AND CORRESPONDENCE

Of course, the entire statement of former Secretary of HUD Patricia Harris will be printed in full in the record, together with her letter.

[The statement and correspondence follow:]

## LETTER FROM PATRICIA HARRIS, SECRETARY OF HEALTH, EDUCATION, AND WELFARE

THE SECRETARY OF HEALTH, EDUCATION, AND WELFARE
WASHINGTON, D.C. 20201

December 4, 1979

Honorable William Proxmire
Chairman, Subcommittee on HUD-
Independent Agencies
Appropriations Committee
United States Senate
Washington, D. C. 20510

Dear Senator Proxmire:

I regret that you have refused to allow me to testify before the Subcommittee on December 5, 1979 on questions relating to management policies and practices during my tenure as Secretary of Housing and Urban Development.

I assume that your decision that my presence is not necessary at this hearing will mean that there will be by you no repetition of the suggestions of misconduct or impropriety on my part that were characteristic of your line of questioning at the Committee hearings on November 13.

I take strong exception to the innuendo and attempted character assassination contained in the first Subcommittee hearing record, and I can only assume that your refusal to permit me to testify on the 5th means that there will be no repetition of efforts to suggest that I, in any way, behaved improperly on the matter of Clifton Terrace. In case there is any doubt in your mind, I gave no orders of any kind to Mr. Clay, or anyone else, to do anything with respect to Clifton Terrace except to protect the interest of the government and honor its obligations, and protect the tenants and the community.

Attached is a copy of the testimony I would have delivered if I had been given the opportunity to appear before the Subcommittee. I request that this letter and this statement be included in the official record of these proceedings.

Sincerely yours,

Patricia Roberts Harris

Patricia Roberts Harris

Attachment

## Statement of Barbara Harris, Secretary of Health, Education, and Welfare

Mr. Chairman, Members of the Committee, I appreciate this opportunity to present this testimony.

It is my purpose to discuss the problems we found in January of 1977 in the inventory of multi-family housing projects of the Department of Housing and Urban Development and the corrective actions we took during my stewardship as the Secretary of Housing and Urban Development.

More than ten years ago this Nation, by Act of Congress, recommitted itself to address, what was called at that time, "the most pressing unfulfilled need of our society: The need to provide the basic necessities of a decent home and healthy surroundings for every American family now imprisoned in the squalor of the slums."

In the decade since the Congress enacted the 1968 Housing Act, much housing has been built. The dream of a decent home has been realized by millions of low income Americans. The Congress, the men and women who have worked to build and maintain this housing and, especially the general public who have given their tax dollars to help others, can be proud of that accomplishment.

With this success, however, came new problems and difficulties. The continuing successful operation of the multi-family housing built under the 1968 Act and earlier programs (particularly Section 236) was dependent on the ability of low income families and the elderly to pay higher and higher rents as the operating costs of their housing, especially the utility costs, increased in the 1970s. The government subsidy to these projects was fixed, and not designed to bridge the gap between project

INCOME AND PROJECT EXPENSES. THE CHAIRMAN OF THIS COMMITTEE STATED IN OCTOBER 1977 "AT THE BOTTOM THE PROBLEM APPEARS TO BE UNCONTROLLABLE AND RAPIDLY INCREASING OPERATING EXPENSES. THESE COSTS HAVE RISEN AT A FAR FASTER PACE THAN THE INCOMES OF THE TENANTS WHO MUST ULTIMATELY PAY FOR THEM."

PRINCIPALLY AS A RESULT OF THIS DISPARITY BETWEEN INCOME AND COSTS, MANY PROJECTS FAILED. WHEN A PROJECT FAILS TO MEET ITS MORTGAGE PAYMENTS, THE FEDERAL GOVERNMENT IS OBLIGATED, UNDER ITS MORTGAGE INSURANCE CONTRACT WITH THE PRIVATE LENDER, TO STEP IN AND BECOME THE OWNER OF THE MORTGAGE. IN 1974, THE FEDERAL GOVERNMENT BECAME THE OWNER OF 404 PROJECT MORTGAGES; IN 1975, IT ACQUIRED 528 MORTGAGES; IN 1976, IT ACQUIRED 312 MORTGAGES. WHEN THIS ADMINISTRATION TOOK OFFICE IN JANUARY 1977, HUD HELD THE MORTGAGES ON 2,116 PROJECTS, 893 OF WHICH WERE FOR HOUSING PRODUCED FOR LOW AND MODERATE INCOME PEOPLE. BY DEFINITION, THESE MORTGAGES WERE DELINQUENT; UNABLE TO STAY CURRENT WITH THEIR ORIGINAL MORTGAGE TERMS.

IN ADDITION, HUD HAD ACQUIRED OWNERSHIP OF 183 FORMERLY SUBSIDIZED PROJECTS, MOST OF WHICH WERE NOT ONLY FINANCIALLY DISTRESSED, BUT IN POOR PHYSICAL CONDITION AS WELL.

A POINT OF CRISIS WAS REACHED. TENANTS WERE BEING DISPLACED; HOUSING FELL INTO DISREPAIR; TENANTS, COMMUNITIES, AND NEIGHBORHOODS SUFFERED THE CONSEQUENCES OF THESE FAILURES. ON JANUARY 14, 1977, NINE DAYS BEFORE I TOOK OFFICE, FORMER SENATOR BROOKE, THEN THE RANKING MEMBER OF BOTH THIS COMMITTEE AND OF YOUR AUTHORIZING COMMITTEE, SENT A TELEGRAM TO HUD SECRETARY CARLA HILLS URGING HER TO CONTINUE HER RESTRICTION OF FORECLOSURE OF SUBSIDIZED HOUSING PROJECTS AND TO HALT ALL SALES UNTIL THE NEW HUD SECRETARY HAD AN OPPORTUNITY TO REVIEW THIS SERIOUS PROBLEM. SENATOR BROOKE

STATED THAT "THIS ACTION WAS INTENDED TO GIVE HUD AND OTHER CONCERNED INDIVIDUALS AND GROUPS THE TIME TO DEVELOP A STRATEGY FOR DEALING WITH THIS CRISIS SITUATION."

IN APRIL 1977, SENATOR PROXMIRE'S COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS HELD HEARINGS IN BOSTON ON THE PROBLEMS IN MULTI-FAMILY SUBSIDIZED HOUSING IN THAT CITY WHICH EPITOMIZED THE PROBLEMS FACING MANY PROJECTS IN CITIES ACROSS AMERICA. THESE HEARINGS DREW THE ATTENTION OF THE CONGRESS AND HUD TO URGENT QUESTIONS OF FEDERAL HOUSING POLICY SURROUNDING THESE TROUBLED PROJECTS. THE ISSUES RAISED INCLUDED:

- HOW WOULD THE FEDERAL GOVERNMENT ASSURE THAT THIS HOUSING WOULD REMAIN AVAILABLE TO AND AFFORDABLE BY ITS LOW INCOME RESIDENTS?

- HOW WOULD HUD ASSURE THAT THIS HOUSING WOULD BE RESTORED TO AND MAINTAINED IN GOOD PHYSICAL CONDITION?

- HOW WOULD HUD AFFORD A ROLE TO TENANTS AND COMMUNITY ORGANIZATIONS IN THE MANAGEMENT AND DISPOSITION OF HUD-OWNED PROPERTIES?

- WHAT LEGISLATIVE AND ADMINISTRATIVE CHANGES WERE NECESSARY TO PROVIDE ADDITIONAL RESOURCES AND IMPROVE MANAGEMENT?

- WHAT WERE THE BEST AND LEAST COSTLY METHODS OF PRESERVING LOW INCOME HOUSING BUILT AT 1/3 OR 1/2 THE COST OF HOUSING BUILT TODAY?

AS THE CHAIRMAN STATED AT THE FOLLOW-UP HEARING ON DISTRESSED HUD SUBSIDIZED MULTI-FAMILY PROJECTS IN OCTOBER, 1977, HUD had "come in for considerable criticism for its failure to protect the interests of the low income tenants by refusing to implement (subsidies) and for failing to insure that when projects it holds are sold that measures are taken to preserve the low-and moderate-income character of these projects."

In addition, recent federal court decisions, most notably the Kent Farms case decided in the U.S. District Court for the District of Columbia in 1976, held that "HUD is not simply a banker," free to foreclose on the basis of a legal default. "(L)ack (of) financial promise... alone is not enough to justify foreclosure."

These were urgent questions and important criticisms.

In response to these criticisms and to my own belief that the central question before HUD was how to maintain this critically needed housing for low and moderate income persons, I commissioned in June 1977 the formation of the Multi-family Property Utilization Task Force. This Task Force began to define the causes of troubled projects and to set forth the policies, programs and procedures necessary to address these problems in a way consistent with the intent of Congress.

The Task Force verified that these troubled projects suffered principally from a lack of income, and that project expenditures were rising more rapidly than project income -- a problem beyond the means of low income tenants and the legal obligations of project owners. It also found that additional resources and financial tools were needed. But most importantly, HUD took a hard and critical look at its own house.

The Task Force also found that a major problem area for the Department was "inadequate HUD management of multi-family loans, including irregular and incomplete physical, administrative and financial reviews due to inefficient management resources (staff, skills, tools) and inefficient management environment (structure, guidelines, goals). These problems and findings were set before the Chairman's Committee on Banking, Housing and Urban Affairs in October 1977.

It should be noted that the recently released Investigations Staff Report of this Committee relied extensively on HUD's own report in citing these criticisms. However, for some reason that report failed to describe either comprehensively or in detail the numerous programmatic and administrative changes made by HUD in the last two years to reform its own internal management procedures; to improve the management of projects; and, to provide the additional resources needed to do a proper job.

The Department has submitted today, for the record, a report detailing the problems faced by HUD in the loan management and property disposition areas and the steps that have been taken and those being taken to correct these problems. To put it simply, when I took office in January of 1977, this Administration found a Department that was woefully unprepared to oversee the management of low income housing; unprepared in its attitudes, its policies, and its administrative procedures. When I left, we had put into place a process for changing those conditions. Although the report submitted by HUD today sets forth more comprehensively the changes that have been made, I would like to mention a few of them.

One of the most important policy changes made by this

Administration was the decision to preserve as low income housing the multi-million dollar housing investment represented by the Department's subsidized and formerly subsidized troubled projects.

We decided to put our own house in order first. To accomplish this, HUD increased its field management staff by 356 positions, from 793 in FY 1977 to 1,150 for this year. I need not remind the Committee how difficult it has been for a HUD Secretary to obtain additional staff and, in fact, the Department is now staffed below its minimum work measurement standards despite the increase I mentioned.

With respect to HUD-owned properties, we made the following important decisions.

First, we decided to repair all properties which the Department owned to insure that tenants in these projects were provided good and decent housing.

Second, in May of 1977, I directed that no tenant living in a formerly subsidized project should be required to pay more than 25 percent of income for rent.

Third, to prevent displacement of low and moderate income families after the sale of HUD-owned projects, with Congress' approval, I made Section 8 subsidies available for low and moderate income tenants who remained in the projects.

These initial policy decisions were the first steps we took to deal with a set of problems affecting projects, families and neighborhoods across this country. Taken together, these policies were designed to respond to recommendations made by tenants, project owners and managers, professional housing associations, private consultants, by this Committee and the Congress in the Housing and Community Development Act of 1978.

We recognized that more had to be done, and more was done.

To create clear lines of accountability for the implementation of these new policies, the housing function in Central Office was reorganized. The Offices of Loan Management and Property Disposition which had emphasized the mechanical aspects of "servicing loans" and "disposing of property" were eliminated. In their place, the Office of Management and Occupancy and the Office of Financing and Preservation were established in November 1978.

The Office of Management and Occupancy was given the task of developing and implementing new HUD policies and procedures emphasizing quality property management; aggressive, preventative servicing; sound project problem analysis; comprehensive problem resolution; and effective project monitoring, while the Office of Financing and Preservation was given the responsibility of applying these new policies to HUD's troubled assigned and HUD-owned projects.

No policies, however well conceived, stay in place unless they are institutionalized. I asked my Under Secretary to do this and it was done.

For the first time, management goals were established in the Department's management system (EMR). The most important of these called for placing 90 percent of all HUD-held projects under a workout plan by the end of the 1979 fiscal year. Although that goal was not reached, the Department made substantial progress toward it -- increasing the percent of projects under a plan from 68 percent at the beginning of the year to 80 percent by year end. What is important is that we watched what we were doing carefully.

The most important corrective measure, however, was the Flexible Subsidy Program, which I requested from the

Congress in 1978 and received authority to implement it with the Housing Acts of that year. This program allows a relatively small investment of additional Federal funds, to save a significant number of projects from assignment and foreclosure, resulting in substantial savings to the Federal Government.

The Flexible Subsidy Program is representative of the important changes which have been made in the Department's loan servicing and project monitoring efforts, and, if I may say so, the new attitude we tried to create at HUD.

It is a totally new way of approaching troubled projects. It requires identification and thorough analysis of a project's financial, physical, management, and tenant problems; and proposal of a comprehensive solution -- including a financial contribution from the owner and an agreement to improve the project's management, if needed. In addition, loan servicers must closely monitor the implementation of relief plans and continuously evaluate progress toward solving project problems. Although these aggressive, active servicing procedures were developed for the Flexible Subsidy Program, they are presently being extended to cover all troubled projects regardless of the method of dealing with the project.

All of the policy changes I have described were responsive to the more than 800 pages of testimony on distressed projects taken by the Chairman's Committee in April and October 1977. The changes are also responsive to the Housing and Community Development Act Amendments of 1978. The 1978 Act mandated that HUD manage and sell subsidized projects in a manner that will preserve their low income character.

These policy changes marked a significant departure from the policies of previous Administrations and signaled

THE BEGINNING OF A NEW APPROACH BY HUD TOWARD ITS MANAGEMENT RESPONSIBILITIES FOR TROUBLED PROJECTS.

I DO NOT MEAN TO SUGGEST THAT THERE ARE NOT STILL SERIOUS DIFFICULTIES MANAGING AND IMPROVING THE PROJECTS IN QUESTION. I WANT TO UNDERSCORE, HOWEVER, THAT WITH THE HELP OF THIS BODY AND THE ENTIRE CONGRESS, SERIOUS EFFORTS WERE MADE TO CORRECT PROBLEMS THAT WERE LEFT UNATTENDED FOR NEARLY A DECADE.

TO PUT IT SIMPLY, WE WORKED FOR SOME THIRTY MONTHS TO DEFINE THE PROBLEM, TO DEVELOP POLICY RESPONSES, AND TO INSTITUTIONALIZE THOSE RESPONSES IN THE DAILY MANAGEMENT PRACTICES OF THE DEPARTMENT.

WE DID NOT ACCOMPLISH EVERYTHING WE SET OUT TO DO, BUT WE DID PUT IN PLACE THE FOUNDATION UPON WHICH A BETTER MANAGEMENT STRUCTURE CAN BE BUILT IN THE MONTHS AND YEARS AHEAD. ACCOMPLISHING THAT TASK WILL BE MUCH MORE DIFFICULT IF THE POSITIVE STRIDES MADE BY THIS ADMINISTRATION AND THE CONGRESS ARE NOT GIVEN TIME TO TAKE EFFECT. SPECIFICALLY, IF THIS BODY FOCUSES PUBLIC ATTENTION ON THE PAST POLICY FAILURES -- FAILURES WHICH WE ALL RECOGNIZED TWO AND A HALF YEARS AGO, FAILURES WHICH WE HAVE BEEN TRYING TO CORRECT -- AND FAILS TO PORTRAY ACCURATELY THE GOVERNMENT'S RESPONSE TO CORRECT THESE CONDITIONS, IT WILL DO A SERIOUS DISSERVICE TO THE MANY PEOPLE IN HUD, IN THE ADMINISTRATION, IN THIS BODY, AND ACROSS THE COUNTRY WHO ARE TRYING TO MAKE THE HOUSING PROGRAMS WORK EFFECTIVELY FOR THE PEOPLE THEY WERE INTENDED TO SERVE. FURTHERMORE, UNLESS THERE IS A CLEAR PUBLIC PERCEPTION -- AS THERE WAS WITH THE ENACTMENT OF THE FLEXIBLE SUBSIDY PROGRAM -- THAT THE CONGRESS AND THE ADMINISTRATION ARE WORKING TOGETHER TO SOLVE THESE COMPLEX POLICY QUESTIONS, I DOUBT THAT WE CAN MAINTAIN THE BROAD-BASED PUBLIC SUPPORT FOR THESE EFFORTS AND ALL OF THE FEDERAL HOUSING PROGRAMS IN THE YEARS AHEAD.

All of us who have worked with these programs know that our goal of providing a decent, affordable living environment for every American has not yet been realized.

If public support is lost for efforts because public attention is focused on past failures, we inadvertently undermine our chances of ever attaining the goal so many have held for nearly forty years.

This reality must be kept in mind as this body undertakes both its evaluation of what HUD has tried to do and is continuing to do to resolve what amounts to some of the most difficult public policy questions before the government.

I have always thought that the key to sound management is to pick good people, give them clear policy directions and back them up.

I did that at HUD, and I am proud of the people who were part of my team and I am proud of the work they did. And, the real meaning of this testimony is to let everyone know that their labor must not be distorted or dismissed if public service is to continue to be the calling you and I know it to be.

Before concluding I would like to address another issue. It is my understanding that the Committee will use today's session to probe the Department's handling of Clifton Terrace. Assistant Secretary Simons has informed me that he is prepared to present the Department's record in terms of the specifics on that matter.

Before he does, I would like to say the following about Clifton Terrace. At no time did I or anyone working for me instruct any employee of HUD to change policy recommendations made about that project. When decisions were made by me to

CHANGE POLICIES OR SPECIFIC RECOMMENDATIONS, SUCH CHANGES WERE MADE ON THE RECORD. IF THERE IS NO RECORD OF INSTRUCTIONS TO CHANGE POLICY ON ANY MATTER THAT WAS BROUGHT TO ME, IT IS BECAUSE NO SUCH INSTRUCTIONS WERE GIVEN, ON CLIFTON TERRACE OR ANY OTHER MATTER.

NEITHER I NOR ANY EMPLOYEE ACTING ON MY BEHALF INSTRUCTED HUD CAREER EMPLOYEES TO MAKE ANY DECISIONS OR DO ANY ACT OTHER THAN THOSE DICTATED BY THE RESPONSIBILITIES OF THEIR OFFICE AND THEIR OATH OF OFFICE. INNUENDOES OR SUGGESTIONS TO THE CONTRARY ARE FALSE.

IN AN ALMOST TRAGIC WAY, THE ENTIRE SAGA OF CLIFTON TERRACE PROTRAYS JUST HOW DIFFICULT IT CAN BE TO MAKE TROUBLED PROJECTS WORK FOR THE COMMUNITY OF WHICH THEY ARE PART.

IT WOULD BE A FORM OF MCCARTHYISM AT ITS WORST IF THE GOVERNMENT, AND THE MANY INDIVIDUALS WHO ACTED IN GOOD FAITH WERE TO BE HELD ACCOUNTABLE FOR THE IRRESPONSIBILITY AND THE ALLEGED ILLEGAL ACTIONS OF THE OWNERS OF CLIFTON TERRACE. IF THERE WAS IMPROPRIETY OR CRIMINAL BEHAVIOR AT CLIFTON TERRACE BETWEEN JANUARY 21, 1977 AND AUGUST 3, 1979, NONE OF IT WAS RELATED IN ANY WAY TO THE SECRETARY OF HOUSING AND URBAN DEVELOPMENT, HER STAFF, OR THE ASSISTANT SECRETARY FOR HOUSING OR THE DEPUTY ASSISTANT SECRETARY.

IT IS IMPERATIVE AS THIS COMMITTEE CONTINUES ITS ANALYSIS OF THESE EVENTS AND THE LARGER QUESTIONS AT ISSUE, THAT THIS FACT BE KEPT IN MIND. IT IS IMPORTANT THAT THE FINAL STORY OF CLIFTON TERRACE IS AN ACCURATE AND FACTUAL RECORD OF WHAT ACTUALLY OCCURRED, AND THAT THE ENTIRE QUESTION BE PUT INTO THE LARGER CONTEXT OF HUD'S EXPERIENCE WITH TROUBLED PROJECTS. IT IS CERTAINLY A MORE DIFFICULT AND DEMANDING APPROACH TO THESE ISSUES THAN AT LEAST ONE

LOCAL NEWSPAPER HAS BEEN WILLING TO TAKE. BUT IT IS THE APPROACH THIS COMMITTEE MUST TAKE IF THE PUBLIC INTEREST IS TO BE SERVED AND IF THE MOMENTUM WE HAVE CREATED TOGETHER TO IMPROVE THE NATION'S HOUSING PROGRAMS ARE TO BE MAINTAINED.

THANK YOU, AND I WILL NOW ANSWER ANY QUESTIONS YOU MAY HAVE.

## STATEMENT OF HON. PATRICK J. LEAHY, U.S. SENATOR FROM VERMONT

Senator PROXMIRE. Senator Leahy?

Senator LEAHY. Mr. Chairman, I must apologize. I am only going to be here very, very briefly. I have an amendment to the windfall profits tax of some significance which is on the floor right now under a time order. It will be necessary for me to be there with it.

I agree with the chairman, this committee is not a court. It is not intended to be. The U.S. attorney, I understand, is looking into the question of Clifton Terrace. I am sure if crimes have been committed there in any way, the U.S. attorney will prosecute. They are far better able to do that than we are to investigate it and prosecute it. I don't think that should be the purpose of this committee.

But tightening controls does not mean stopping housing. I don't think it is an either/or situation. I believe we can do both. I discussed this with Assistant Secretary Simons before. I know of his strong commitment to housing needs. I also know from what experience I have had on this committee, under your guidance, Mr. Chairman, and also in one other committee on which I serve which has some housing authority, that the last resort housing is extremely difficult just by its very nature.

The kind of housing that we and our families are fortunate to enjoy is not the kind of housing being dealt with here. The kind of housing that I can have in Vermont is something I feel very grateful that I can have. And I do not have such concerns, as so many others do, even as so many Vermonters do.

Even the housing I have in Washington falls into the same category. We are also fortunate to have it but we also do not have to face the very grave problems that so many others less fortunate in the Washington area do.

I think it is wise that HUD look at this very carefully to see if mistakes are made, where they are made and how they can be corrected. However, I don't think we should lose sight of the fact that a lot of the housing we are talking about is last resort housing. We are not dealing with the kind of housing which many of us with adequate incomes can go and pick out and buy. We are looking at people where it is that housing or no housing. That is where the problems arise.

I hope that we do not lose sight of the social commitment that this country has to provide housing for its people, or that we lose sight of the anomaly that the world's richest and most powerful Nation has some of the greatest poverty and deprivation seen in the industrial world.

So I will look forward, Mr. Chairman, to seeing the record of this hearing, especially because I have worked with HUD a number of times on matters that involve my State or involve primarily rural areas.

Secretary Simons testified before the Rural Development Subcommittee just 1 week ago pointing out the difficulties of administering housing programs of all natures. We have different levels of income, different problems from urban to rural, and so forth. I would hope that neither this committee nor any other committee would lose sight of the basic commitment this country has to adequate housing as we go into these hearings.

Mr. Chairman, I appreciate the courtesy of being able to make the statement. I apologize I have to leave. I will go back and parlance votes and hope to line up yours, too, at 1 o'clock this afternoon.

Senator PROXMIRE. Thank you. We particularly appreciate Senator Leahy's courtesy in coming. He does have an amendment that will be debated between now and 1 o'clock. Senator Leahy is very concerned about the hearings.

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## SECRETARY, HOUSING AND URBAN DEVELOPMENT

## STATEMENT OF HON. MOON LANDRIEU, SECRETARY, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

ACCOMPANIED BY:
- LARRY SIMONS, ASSISTANT SECRETARY FOR HOUSING
- MARILYN MELKONIAN, DEPUTY ASSISTANT SECRETARY FOR MULTIFAMILY PROGRAMS
- CHARLES DEMPSEY, INSPECTOR GENERAL

### OPENING REMARKS BY SENATOR PROXMIRE

Senator PROXMIRE. Secretary Landrieu, we are happy to have you with us today. We also have statements from Assistant Secretary Simons and from Deputy Assistant Secretary Melkonian. And I see that your Inspector General is with you today.

I would like to have Mr. Cameron and Mr. Clay come forward, too, to sit at the witness table, if they would so that we can have them present during the questioning.

Secretary Landrieu, go right ahead.

Secretary LANDRIEU. Thank you, Mr. Chairman. This is the first time that I have been before this committee since my confirmation hearings, and I am not unmindful of the courtesy which we received at that time from the chairman. We deeply appreciate that.

I also appreciate the candor and frankness with which the chairman has expressed his opinion of Mrs. Harris. I think it takes an unusual person to acknowledge such a public opinion having expressed some opposition at her confirmation. So I admire you, too, for that, Mr. Chairman.

### INTRODUCTION OF ASSOCIATES

I have with me this morning Assistant Secretary for Housing Larry Simons and his Deputy Assistant Secretary for Multifamily Programs, Marilyn Melkonian, and the HUD IG, Mr. Charles Dempsey. Each of us, with your permission, Mr. Chairman, will make a statement and I hope that, in the process, we will answer the three questions which you have raised.

I think those three questions are pertinent and I think they should be addressed.

This hearing, in my judgment, can produce a great deal of good for HUD and for our housing programs. I think it is essential that Congress analyze the effectiveness of the departments over which it has supervision, and I hope that from it comes some constructive change and a good exchange of information.

On the downside, there is, unfortunately, as a consequence of hearings such as this, always some hurt feelings. We get the feeling sometimes that we are under attack and actually everyone wants to respond to protect their own integrity and to state their own position. To some extent, there is an unsettling feature about hearings which are investigative in nature within the Department. That may not be altogether bad, but it does at times force people to try to justify the decisions they made at a certain course in history which for the most part are most rational and prudential decisions but which when viewed in the light of recent history may require some explanation.

I am hoping, Mr. Chairman, that as we proceed through this testimony, we will try to point out if HUD did, in fact, go wrong and where we went wrong, and what steps we are taking and have been taking to improve our system of monitoring and management and hopefully there will grow out of this hearing a respect for the way in which the HUD personnel have been administering the national housing programs for this country.

When I went to HUD, I found, not to my surprise, but to my great pleasure, a very, very dedicated group of employees. Not only is that dedication widely spread in the Department, it is very deep. The employees are extraordinarily competent, both in the central office and in the field.

The problems, as we will point out in our testimony, are enormous in trying to administer a housing program for this Nation and in the process of that administration, there will be errors made.

So far as we can find, Mr. Chairman, the actions of all within HUD have been most appropriate and all have acted, in my judgment, with the greatest of circumvention. So with that preliminary, let me make a formal statement for the record.

I want to thank the committee for giving the Department an opportunity to respond to some of the serious concerns that were raised by this committee and witnesses at the hearing held on November 13. Those concerns related in part to the circumstances surrounding HUD's decision to foreclose the mortgage it held on Clifton Terrace in June 1978, when that project was owned by P.I. Properties, Inc., the real estate arm of Pride.

## BASIC INTEGRITY OF HOUSING PROGRAMS

Those concerns related also to broader questions of HUD's oversight and management of projects insured or previously insured under HUD's multifamily mortgage insurance programs, with particular emphasis on projects that have serious management, financial or physical problems.

These concerns were heightened by the issuance of the report of your investigative staff, in preparation for over 6 months, which focused on both policy and procedural questions of the Department regarding the multifamily projects on which HUD holds the mortgage and also projects which the Department has acquired.

Your report also pointed out several instances of possible fraud or abuse in the Department's programs which caused the chairman to be concerned whether Clifton Terrace represents a more serious management problem for the Department.

I am happy to come before you today to assure this committee that neither the individual project nor projects of concern to the committee today, nor any other issues that have been raised, are grounds to doubt the basic integrity and soundness of the housing programs or the overall competency of HUD's management.

### HUD'S TROUBLED MULTIFAMILY PROJECTS

What these projects, other testimony, and your report do focus on is an area of the Department's continuing work dealing with troubled projects.

The problems relating to these projects, most of which HUD owns or holds the mortgage on, have been discussed many times before this committee, the authorizing committee, and other committees of the Congress.

Most of these projects became part of the Department's inventory of mortgages or were acquired as a result of the unusually severe economic conditions which afflicted the real estate industry nationally in the period 1974–76. Prior to 1974, HUD held 1,201 mortgages; however, only 3 years later, by December 1976, it held 2,116 mortgages. In short, HUD found itself in the multifamily management and mortgage banking business almost overnight, with the resulting need to adjust its attitudes, policies, resources and internal management.

That process of change and adjustment began before the Carter administration took office and it has continued and accelerated under this administration, in keeping with the legislative intent and mandates of the Congress.

That process relates specifically to a more complete understanding of the problems facing a project like Clifton Terrace. Assistant Secretary Simons and Deputy Assistant Secretary Melkonian——

Senator PROXMIRE. Secretary Landrieu, I apologize and I am sorry I have to interrupt you. There is a rollcall in the Senate. We have to recess for 10 minutes. I will be back as quickly as I can.

Secretary LANDRIEU. We understand, sir.

[A brief recess was taken.]

Senator PROXMIRE. Again, I apologize, Mr. Secretary. Go right ahead, sir.

Secretary LANDRIEU. I have reviewed, Mr. Chairman, the summary record of the Department's actions in connection with this case and although it is never pleasant to acknowledge a failure, it is not the record of conspiracy, coverup, or incompetence that some would make it out to be. It did point up weaknesses in HUD's monitoring and oversight of troubled projects. However, many of these weaknesses were already being addressed through changes in the Department's programs or procedures.

Before we begin that discussion, however, I wish to discuss briefly the problems facing this Department in 1977, when the present administration took office, and the action taken since to respond to those problems.

## LOW-INCOME HOUSING PROGRAMS SINCE 1968 ACT

More than 10 years ago this Nation, by act of Congress, recommitted itself to address what was called at that time the most pressing unfulfilled need of our society: The need to provide the basic necessities of a decent home and healthy surroundings for every American family now imprisoned in the squalor of the slums.

In the decade since the Congress enacted the 1968 Housing Act, much housing has been built. The dream of a decent home has been realized by millions of low-income Americans. The Congress, the men and women who have worked to build and maintain this housing and especially the general public, who have given their tax dollars to help others, can be proud of that accomplishment.

### SOURCE OF PRESENT DIFFICULTIES

With this success, however, came new problems and difficulties. The continuing successful operation of the multifamily housing built under the 1968 Act and earlier programs—particularly section 236—was dependent on the ability of low-income families and the elderly to pay higher and higher rents as the operating costs of their housing, especially the utility costs, increased in the 1970's. The Government subsidy to these projects was fixed and not designed to bridge the gap between project income and project expenses.

The chairman of this committee stated in October 1977:

> At the bottom the problem appears to be uncontrollable and rapidly increasing operating expenses. These costs have risen at a far faster pace than the incomes of the tenants who must ultimately pay for them.

We concur in this assessment.

Principally as a result of this disparity between income and costs, many projects did fail. When a project fails to meet its mortgage payments, the Federal Government is obligated, under its mortgage insurance contract with the private lender, to step in and become the owner of the mortgage. In 1974, the Federal Government became the owner of 404 project mortgages; in 1975, it acquired 528 mortgages; and in 1976, it acquired 312 mortgages. When this administration took office in January 1977, HUD held the mortgages on 2,116 projects, 893 of which were for housing produced for low- and moderate-income people.

In addition, HUD had acquired ownership of 183 formerly subsidized projects, most of which were not only financially distressed, but in poor physical condition as well.

A point of crisis was reached. Tenants were being displaced; housing fell into disrepair; tenants, communities, and neighborhoods suffered the consequences of these failures.

On January 14, 1977, former Senator Brooke, then the ranking member of your authorizing committee, sent a telegram to HUD Secretary Carla Hills urging her to continue her restriction of foreclosure of subsidized housing projects and to halt all sales until the new HUD Secretary had an opportunity to review this serious problem. Senator Brooke stated that, "This action was intended to give HUD and other concerned individuals and groups the time to develop a strategy for dealing with this crisis situation."

### 1977 HEARINGS ON DISTRESSED MULTIFAMILY PROJECTS

In April 1977, the chairman's Committee on Banking, Housing, and Urban Affairs held hearings in Boston on the problems in multifamily subsidized housing in that city which epitomized the problems facing many projects in cities across America. These hearings drew the attention of the Congress and HUD to urgent questions of Federal housing policy surrounding these troubled projects. The issues raised include:

How would the Federal Government assure that this housing would remain available to and affordable by its low-income residents?

How would HUD assure that this housing would be restored to and maintained in good physical condition?

How would HUD afford a role to tenants and community organizations in the management and disposition of HUD-owned properties?

What legislative and administrative changes were necessary to provide additional resources and improve management?

What were the best and least costly methods of preserving low-income housing built at one-third or one-half the cost of housing built today?

As the chairman stated at the followup hearing on distressed HUD subsidized multifamily projects in October 1977, HUD had—

> Come in for considerable criticism for its failure to protect the interests of the low-income tenants by refusing to implement (subsidies) and for failing to insure that when projects it holds are sold that measures are taken to preserve the low- and moderate-income character of these projects.

### MULTIFAMILY PROPERTY UTILIZATION TASK FORCE

These were urgent questions and important criticisms.

In response to these criticisms, in June 1977 HUD established the multifamily property utilization task force. This task force began to define the policies, programs, and procedures necessary to address these problems in a way consistent with the intent of Congress.

The task force verified that these troubled projects suffered principally from a lack of income, and that project expenditures were rising more rapidly than project income—a problem beyond the means of low-income tenants and the legal obligations of project owners. It also found that additional resources and financial tools were needed. But most importantly, HUD took a hard and critical look at its own house.

The task force also found that a major problem area for the Department was inadequate HUD management of multifamily loans including irregular and incomplete physical, administrative and financial reviews due to inefficient management resources; that is, staff, skills, tools, and inefficient management environment—structure, guidelines, and goals. These problems and findings were set before the chairman's Committee on Banking, Housing, and Urban Affairs in October of 1977.

It should be noted that the recently released investigations staff report of this committee relied extensively on HUD's own report in citing these criticisms. However, numerous programmatic and administrative changes have been made by HUD in the last 2 years to reform its own internal management procedures; to improve the management of projects; and to provide the additional resources needed to do a proper job.

The Department would like to submit for the record a report detailing the problems faced by HUD in the loan management and property disposition areas and the steps that have been taken and those being taken to correct these problems. To put it simply, in January 1977, this Administration found a department that was not prepared to oversee the management of low-income housing; unprepared in its attitude, its policies, and its administrative procedures.

[The report follows:]

# HUD'S EFFORTS TO IMPROVE THE MANAGEMENT OF ITS MULTIFAMILY HOUSING PROGRAMS

## I. INTRODUCTION: THE PROBLEM

Beginning with the Housing Act of 1961 and the introduction of the Section 221(d)(3) Below Market Interest Rate (BMIR) subsidized housing program, described by the Congress at the time as "a new and untried approach," the Federal Government committed itself to providing decent, safe and sanitary housing for low and moderate income families. This commitment was renewed in 1968 when Congress replaced the Section 221 (d)(3) program with an even deeper interest subsidy program -- Section 236.

In the years since these programs were enacted, almost 8000 subsidized multifamily housing projects containing over 750,000 units have been built. The vast majority of the projects (almost 85 percent) were and continue to be successful, supplying millions of low and moderate income individuals and families with decent housing built by private developers and made affordable through government subsidies.

Despite the overall success of these programs, however, a basic assumption upon which these programs rested proved to be inaccurate. Underwriting procedures assumed that increases in tenant incomes would keep pace with inflationary increases in operating costs. This did not happen. The decade of the 1970's saw sharp and uncontrollable increases in energy costs, taxes and insurance, maintenance and materials costs, and other operating costs without a corresponding increase in the incomes of tenants. In most areas of the country, operating expenses increased at twice the rate tenant incomes did. These rapidly rising costs placed severe financial burdens on the limited cash flows generated by subsidized projects. The situation was summarized by Chairman William Proxmire of this Committee in hearings in October, 1977 when he said, "at bottom the problem appears to be uncontrollable and rapidly increasing operating expenses. These costs have risen at a far faster pace than the incomes of the tenants who must ultimately pay for them."

Contributing to this situation was the fact that HUD, as an organization, did not deal effectively with the new responsibilities placed on it by the subsidized housing programs. This occured, in part, because the Department's management systems and operating procedures were based on its earlier experiences with unsubsidized, largely middle-income, non-inner city housing projects which required less oversight and monitoring by the government. Even more important, however, was the fact that the Department's traditional attitudes toward its housing role crippled any effort to deal with problems once they occurred. Behind the Department's failure to act was the long-held belief that the government was not responsible for this housing after it was built except to pay an insurance claim and dispose of the property, if necessary. As a result, the Department's management and disposition policies never contemplated the needs and problems of subsidized housing and its tenants, or the long term need to protect this investment after a claim was paid. National policies had not been developed to preserve this housing; and handbooks, training, operating instructions, and general organizational structures were never adequately revised to address the new circumstances of subsidized housing. Management and property disposition functions were consistently understaffed to deal with these problems and, although there were heroic exceptions, management and disposition staffs were often used as "dumping grounds" for unskilled and unmotivated employees. Behind this surface attitude was the deeply held view that there was little tangible value to troubled housing and that the Department should not be responsible for the deteriorating quality of life of the people living there.

These factors combined during the mid-1970's to produce project failures of crisis proportions. While only 813 subsidized mortgages had been assigned to the Department between 1962 and 1974, 404 mortgages were assigned in 1974 alone. By the time this Administration took office in 1977, HUD held the mortgages on almost 900 subsidized projects, and it was the owner of 183 more formerly subsidized projects.

The financial impact of these project failures on the Department's Special Risk and General Insurance funds was substantial. Monthly mortgage insurance premiums collected from project owners were no longer sufficient to cover insurance claims and other expenses associated with assigned and HUD-owned projects. In 1976, the Department, for the first time, was forced to request Congressional appropriations to replenish both the Special Risk and the General Insurance Funds. Even so, in the history of the mortgage insurance programs, under which almost $37 billion in insurance has been written, the losses not covered by premiums and, hence, appropriated by Congress have totalled $2.87 billion -- only 7.7 percent of the total insurance written. This relatively low percentage is especially impressive in that, when the Special Risk Insurance Fund was established by the Congress, it was never intended that insurance premiums should cover all claims against the fund.

In addition to this serious financial impact, these failures have also severely affected the tenants residing in the projects and the neighborhoods in which the projects were located. During this period, HUD's image reflected the problems it was trying to solve, and it gained a reputation as "the nation's largest slumlord."

## II. THE MULTIFAMILY PROPERTY UTILIZATION TASK FORCE

Soon after taking office in 1977, Secretary Patricia Roberts Harris declared her intention to assume responsibility for the long-term success of subsidized housing. She said in April 1977 that she found "an anomaly in a position that in 1968 provides Government assistance for low- and moderate-income people, and then in 1978 says 'drop dead, we don't care.'" The Secretary and the Congress took the view that the Department *is* responsible for the long-term success of subsidized housing, with success defined not only in the narrowest real estate sense (i.e., present income exceeds present expenses) but also in the larger sense that the housing built under these programs must continue to provide a decent living environment at rents affordable by low- and moderate-income people.

Deeply disturbed by the problems of deteriorating conditions in subsidized projects and their effect on tenants, neighborhoods and the insurance fund, the Secretary established a Task Force on Multifamily Property Utilization in June 1977. The purposes of the Task Force were: (1) to determine the causes of the problems being experienced by HUD insured, held, and owned projects; and (2) to recommend actions to restore the soundness of these projects, stabilize project operations and assure that these projects would continue to provide the low-cost, decent, safe and sanitary housing envisioned in national housing legislation.

The Task Force was composed of top HUD staff representing the Secretary and Under Secretary, the Office of General Counsel, the Office of Policy Development and Research, and the Office of Housing. It was co-chaired by Marilyn Melkonian, Deputy Assistant Secretary for Insured and Direct Loan Programs, and Christopher Wye, Director of Special Studies in the Office of Policy Development and Research. The Task Force began work in June 1977 with a field study of 338 subsidized multifamily housing projects located in 12 field office jurisdictions. The Task Force issued two reports -- Preliminary Findings from the Field Study in August 1977 and The Final Report of the Multifamily Property Utilization Task Force in June 1978.

The Task Force found that three general types of problems were persistently present in troubled projects, usually in combination. These problems were: inadequate project income; inadequate on-site project management; and inadequate HUD oversight and management of its project inventory.

Project incomes were generally found to be inadequate to cover current project operating expenses. For most projects, this condition was due to the following:

- An overestimation of project income and an underestimation of project expenses during underwriting; and/or
- A recent, unexpected, uncontrollable growth in project expenses, especially utility bills, taxes, and maintenance and materials costs.

Consequently, the small margin which historically has existed between income and expenses frequently became insufficient to absorb even small increases in operating costs. In recent years, the ability of the margin to absorb higher operating costs has been even further impaired as tenant incomes have grown only half as fast as project expenses.

Inadequate project management, due in part to weak HUD oversight and in part to an insufficient supply of skilled managers, has had a constant adverse impact on many projects throughout their lives. The Task Force concluded that on-site management was particularly weak in the key areas of project financial management, tenant selection, rent collection and maintenance systems and procedures.

HUD management and oversight of the multifamily inventory was also found to be inadequate. Multifamily housing management staff tended to deal with projects on a formalistic basis, emphasizing strict compliance with regulations and completion of paperwork rather than concentrating on the prevention of problems. The staff also tended to treat projects only after they had formally entered a financially troubled category (default, assignment, or acquisition); and they tended to grant relief only for the immediate situation rather than for the long range solution of project problems. The Task Force determined "that the inadequacy of the Loan Management and Property Disposition operation was due primarily to insufficient management resources and an unprofessional, inefficient management environment."

The management resources available to carry out the loan management and property disposition tasks were found to be deficient in the following ways:

- inadequate numbers of professional staff;
- inadequate skills among existing professional staff;
- inadequate monitoring and management information systems;
- inadequate program tools and resources; and
- inadequate secretarial and clerical support.

The Task Force found in some offices that loan servicers were often required to oversee 90 or more projects when most servicers felt they could deal effectively with no more than 40 to 45 projects at a time. In addition, many loan management staff were found to lack the training and skills necessary to carry out their tasks. They also lacked both the programmatic and administrative tools necessary for sound servicing of the inventory, and most offices lacked even the rudiments of a sound management information system to provide essential financial and other project information. Finally, professional staff lacked adequate secretarial and clerical support.

The management environment in which the Housing Management staff functioned was found to be deficient in the following ways:

- inadequate goal definitions and organizational structure;
- **inadequate policy, program, and Handbook guidance;**
- inadequate guidance for complex, substantive decision making; and
- inadequate systems of accountability.

The Task Force found that field office Loan Management Branches lacked clear, consistent, and ordered goals. Regulations and Handbooks frequently addressed routine issues with formulae and checklists but gave little guidance for decisions on difficult, substantive issues. Further, field staff were reluctant to make decisions which could not be supported by the letter of the Handbooks because Headquarters frequently overruled decisions made on any other basis. Finally, the lines of accountability between Headquarters and the field offices and among divisions in field offices were found to be unclear.

It is important to note that while the Task Force did find a high incidence of deferred maintenance, poor management and financial distress, it also found that, in most cases, the problems faced by these troubled projects were solvable. It found, for example, that the majority of the troubled projects studied were well-constructed and well-located and that the problems facing these projects could be solved if management systems were improved and additional program tools and resources were made available to the Department. The Task Force did conclude, however, that subsidies and program tools available at the time were not adequate to address these problems. Existing subsidies did not, for example, provide lump sum cash payments for the correction of deferred maintenance that had accumulated because of the income problem discussed above, nor did these subsidies give the Department sufficient leverage to extract management improvements from project owners.

As a result of its study, the Task Force recommended the following:

- A new subsidy vehicle capable of filling the gap between the rents needed to support project operations and the amount tenants were able to pay, as well as correcting deferred maintenance and replacement and financial obligations resulting from past operating deficits.
- New management initiatives to assure prudent and competent management of projects; and
- More thorough and efficient HUD oversight of projects geared towards detecting and correcting emerging problems before they become serious and developing comprehensive solutions to known problems.

The Task Force also reaffirmed HUD's new attitude toward troubled projects when it concluded that "these proposals reflect HUD's belief that troubled projects represent not only an investment in housing units for low- and moderate-income people, but also in neighborhoods and in the well-being of some of the Nation's major cities."

## III. CHANGES SINCE THE TASK FORCE

Once the Department clearly accepted responsibility for the success of its subsidized projects, the agenda was set for changing its policies and procedures. The most important basic policy change made was the decision to preserve the multi-billion dollar housing investment represented by the Department's troubled project inventory. Rather than lose this housing resource for low- and moderate-income tenants, the Department made the following decisions:

1. Aggressively service HUD's multifamily projects, replacing passive servicing based on reaction to crises with preventive servicing designed to anticipate and prevent trouble;
2. Ensure, through a series of management initiatives, that project management was improved;
3. Develop, in conjunction with project owners and managers, comprehensive solutions to the problems of insured and HUD-held troubled projects and then ensure that these solutions are successfully carried out;
4. Immediately repair properties owned by the Department using the FHA Fund to ensure that tenants in these projects are provided good quality housing as required by the Housing and Community Development Amendments of 1978;
5. Prevent low-income tenants from being displaced when their subsidies cease, as a result of their projects becoming HUD-owned, by requiring tenants to pay no more than 25 percent of income for rent.
6. Sell HUD-owned projects which were housing low- and moderate-income tenants with tenant subsidies in order to prevent tenant displacement and preserve this housing for low- and moderate-income tenants in the future.

In order to implement these decisions and generally improve HUD's management of its subsidized multifamily inventory, the Department was required to make substantial changes in including its organizational structures, management systems, programs and procedures, and tools and resources. The changes made in each of these areas are discussed in detail in the remainder of this document.

## A. Changes in HUD's Organizational Structure

Although some improvements had been made in the way HUD was organized to carry out its Housing functions prior to this Administration taking office, much remained to be done. An earlier reorganization of Headquarters Housing functions finally combined the responsibility for developing housing with that for managing the same housing and had placed this responsibility under a single Assistant Secretary. This was a critical step toward ensuring that the decisions made during each phase of project development take into account the success of that housing during subsequent phases.

Unfortunately, however, the earlier reorganization did not combinine these functions in field offices, nor did it create in either Headquarters or the field the clear lines of authority and responsibility which were required to hold individuals accountable for specific housing functions. For these reasons, the following changes in the Department's Housing organization were made by this Administration:

1. Responsibility for all Phases of Projects' Lives Consolidated. When this Administration took office, the responsibility for both single family and multifamily development, management, and disposition had already been consolidated under the Deputy Assistant Secretary for Insured and Direct Loan Programs. Although this structure successfully combined development and management functions, it also left single-family and multifamily programs combined. To assure that each of these diverse areas received adequate attention, these Headquarters responsibilities were reorganized to place single-family and multifamily programs under separate Deputy Assistant Secretaries.

   At the same time, the field was also reorganized with the creation of a Housing Division under the supervision of a Director. For the first time, one individual in each field office was made responsible for the overall success of multifamily housing projects from the time applications are received until the Department's interest in the projects terminates.

   These new lines of authority require both Headquarters and field staff who take actions during one stage of a project's lifecycle to consider the impact of their decisions on the future feasibility of that project.

2. Clear Lines of Responsibility Create Accountability. In addition to giving one Deputy Assistant Secretary responsibility for the complete lifecycle of a multifamily project, the Headquarters' offices under the Deputy Assistant Secretary have been restructured and renamed to deemphasize the narrow, mechanical functions of collecting loan payments and disposing of properties and to put in their place a structure capable of providing high quality, responsive management across the lifecycle of a project. The Office of Loan Management and the Office of Property Disposition have been replaced by the Office of Management and Occupancy and the Office of Financing and Preservation. The Office of Management and Occupancy is responsible for developing management policies and for monitoring field office performance, while the Office of Financing and Preservation is responsible for supervising the detailed casework required in Headquarters and the field on both HUD-held and HUD-owned troubled projects. Concentrating most of the casework in one office has freed Management and Occupancy for development of policy and procedures and has facilitated continuity in the Department's actions across different stages of a project's lifecycle.

A similar blending of the field office loan management and property disposition branches is also being considered. Under the new arrangement, management specialists would be assigned lead responsibility for projects starting with management input during construction and continuing throughout the insured and, if necessary, the HUD-held and HUD-owned stages.

3. Planning for Future Organizational Needs. Realizing that Federal staffing levels are unlikely to increase dramatically in the near future but also that the number of multifamily units under management -- both subsidized and unsubsidized -- is expected to almost double within the next five years, the Department is beginning to plan now for how it must be organized in the future. In 1978, the management and accounting firm of Peat, Marwick, and Mitchell (PMM) was hired to complete a detailed analysis of the Loan Management function in the field and to recommend, among other things, the changes required to deal with the anticipated growth in the loan management workload. PMM submitted a series of recommendations in June 1979. These recommendations have now become the focus for a series of conferences beginning in February 1980 to develop a detailed plan for restructuring the field offices over the next three years.

## B. Changes in Management Systems

Perhaps the most serious deficiency found by the Task Force -- and confirmed in studies by HUD's Inspector General, the General Accounting Office, and outside researchers -- was HUD's lack of efficient, effective management systems. Criticism focused most heavily on the Department's inability to provide a sufficient number of properly skilled staff for the loan management and property disposition functions. The imbalance between workload and field staff results, in part, from weaknesses in HUD's own management systems, but more importantly, from a shortage in the critical Headquarters staff to make improvements in such systems. Other management areas receiving criticism by the Task Force and others were monitoring, including Headquarters monitoring of the field and field oversight of projects, and data systems. A final area mentioned by the Task Force concerned the lack of priority traditionally placed on management functions.

Management systems are difficult to change because they generally represent a set of widely accepted traditional operating procedures. In addition, responsibility for administering and improving these systems is frequently fragmented. Recognizing this, the Assistant Secretaries of Housing and Administration have established joint working groups to ensure that needed changes in these systems are quickly and comprehensively made. Some efforts already completed or currently underway are described below:

1. Management of Staff Resources Improved. During 1979, significant improvements were made in the Department's ability to estimate Loan Management field staffing needs and to monitor utilization of that staff. These improvements include:

   - Work Measurement Standards. During 1979, the Offices of Housing and Administration developed new work measurement standards for most loan management functions. Unlike the previous standard which awarded a gross number of staff years for each project, the new standard specifies the staff years required to complete each project servicing function (e.g., rental increases, on-site management reviews, annual financial statement reviews, etc.) and awards staff based upon the number of functions and frequency at which each function must be completed. The new standard recognizes that the time required to complete an individual function as well as the total time required to service a project will vary according to the type of project (e.g., subsidized vs unsubsidized; insured vs HUD-held; troubled vs untroubled). The detailed nature of the standard enables Headquarters to easily calculate the staff implications of changes in the mix of project types, addition of new program functions or requirements, or changes in the frequency with which functions must be completed.

   - Staff and Workload Monitoring. The new MIDLIS data system, described below, will enable HUD to determine the total number of projects and the number of troubled projects in each lifecycle stage (development, mangement, or disposition). In addition, recent enhancements to the Regional Employees Timekeeping System (RETRS) will augment Housing's ability to determine if field staff are being utilized for the program areas (e.g., management vs development) and the functions (e.g., troubled project servicing, on-site reviews) for which the staff were allocated. Usuage data supplied by RETRS will also allow monitoring of the accuracy of the work measurement standards on an ongoing basis.

   - Skills Mix. Numerous studies by the Department and others report that neither field nor Headquarters staff have the broad range of skills necessary to manage the Department's housing programs. These skills deficiencies are often attributed to insufficient and poor quality training and to the inappropriateness of existing classification, qualification and job description standards. Each of these areas of concern is currently being addressed.

     As discussed earlier, the Department has hired the management and accounting firm of Peat, Marwick, and Mitchell (PMM) to assist it in designing a new structure for field office loan management branches and in revising hiring practices. One alternative structure under consideration would provide for loan specialists with lead responsibility for projects being supported by technical specialists (e.g., financial analysts, maintenance engineers, occupancy specialists, and contracting specialists) and by paraprofessional loan technicians. New personnel guidelines and hiring practices should improve the Department's ability to select individuals having the skills necessary to support this structure.

     Considerable resources are also being devoted to improving the quality of training offered to field office staff.

Training consultants are assisting instructors in improving delivery techniques, and the addition of field staff to the instructor teams has made course material more appropriate for day-to-day application in the field. In addition, consultants are assisting in developing new training techniques that will increase the availability and scope of training programs. The National Housing Law Project at Berkeley, for example, is developing basic skills courses on financial analysis and management reviews. Both courses will instruct staff on HUD's administrative procedures in these areas as well as on basic underlying concepts including principles of bookkeeping, how to analyze a financial statement and types of on-site management systems (invoices, journals, ledgers, and work scheduling). The courses will be packaged as self-instruction kits with built-in testing components but will also include an instructor guide so that the materials can be presented in a classroom setting. The Department also intends to develop both a videotape based and an on-the-job (OJT) troubled project servicing course. Loan specialists participating in the OJT course will work at a project site to develop a comprehensive workout arrangement. After completing the OJT course, those servicers will serve as moderators for the video-taped based course.

2. Data Systems Improved. The Task Force report and GAO and IG reports have attributed much of the Department's weaknesses in managing its portfolio and monitoring field office performance to the Department's reliance upon primitive automated or even manual management information systems. To address this problem, the Department commissioned a Task Force on Multifamily Data Consolidation in 1977 to design a comprehensive automated system that would: (a) provide program managers at all levels with the information necessary to plan, monitor and evaluate programs; and (b) automate individual processing functions. The overall design of the system has been completed and implementation is underway.

The first phase of the overall plan, the Multifamily Insured and Direct Loan Information System (MIDLIS), is now being implemented. Replacing eight fragmented automated and two incompatible manual systems, MIDLIS will track major actions taken on each Multifamily project during all phases of its lifecycle -- development, loan management, and, if necessary, disposition. MIDLIS will also provide field office profiles and historical profiles on individual projects.

The second phase of the Task Force plan calls for the development of new and the enhancement of existing processing subsystems, linked together by MIDLIS, which will increasingly perform routine work presently handled by professional loan management staff. The major loan management subsystem, the Office of Loan Management System (OLMS), is capable of providing printouts of annual income and expense statements for the most recent three years on every insured and HUD-held project and can calculate average operating costs for similar projects. It can alert field offices to projects which deviate from operating norms. In the future, OLMS will be enhanced to include expense data on HUD-owned projects, to trend historical expense data and to produce an operating budget and rental schedule for the next year. OLMS operating cost data will be automatically fed to the Computerized Underwriting Processing System (CUPS) and should increase the accuracy of operating expense projections made during application processing.

3. Improved Headquarters Monitoring of Field Offices. Recognizing that this function is critical to competent policy evaluation, budget preparation, and performance monitoring, the Department has taken the following steps to improve its field monitoring:

   - New remote monitoring systems. Starting in Spring 1980, the new MIDLIS system will enable Headquarters staff to determine if required servicing activities (e.g., management reviews, physical inspections, annual financial statement reviews) are being completed and if priority attention is being given to the troubled projects. For example, Headquarters will be able to obtain routinely a list of delinquent HUD-held projects on which required on-site reviews have not been completed, on which workouts have expired, and for which annual financial statements have not been received. These remote monitoring systems will facilitate early detection of problems and alert Headquarters to the need for action. In addition, this new capacity will be used to track field office performance and completion of management goals by automatically supplying information to the Department's Executive Management Report (EMR) and its automated operating plan process (OPLAN).

   - Office of Field Monitoring and Operations Established. As part of the recent reorganization of Housing functions in Headquarters, a new Office of Field Monitoring and Operations was created and assigned responsibility for conducting on-site reviews of field offices; allocating the administrative resources -- travel, training and staffing -- which affect the field office's ability to perform; and coordinating and evaluating data supplied by the various remote monitoring systems, particularly RETRS, OPLAN and EMR. By assigning responsibility for these interrelated resources and systems to one office, the Department will improve its ability to act upon deficiencies noted through these remote and on-site monitoring procedures.

4. Management Goals Set. For a number of historical reasons, the Department has traditionally evaluated Office Directors on their ability to achieve goals related primarily to underwriting functions. This is no longer the case. Objectives related to management and preservation functions were included in the Department's operating plan and EMR beginning in 1978. Office Managers and Regional Administrators are now graded on their ability to manage all phases of a project. Inclusion of management-related objectives has helped focus attention of top field staff on management programs and requires Area Managers to adequately staff these as high priority functions. Inclusion of a goal related to maintaining HUD-held projects under approved payment plans, for example, has achieved significant results. During FY 1979, the percentage of HUD-held projects under an approved plan has increased from 62 percent in May 1979 to nearly 80 percent by year end. While this is still 10 percentage points below the goal, it is a substantial improvement in performance. It is fully expected that the 90 percent goal will be met by the close of FY 1980.

5. Enhance Field Office Management Ability. Increased use of automated systems, changes in servicing procedures and delegations of authority, and use of "third-party servicers" should improve the field offices' ability to monitor projects and to intervene in troubled projects when necessary.

   - Automated Systems. With data loading problems just about resolved, OLMS will become fully operational in the near future and will provide field offices with the income and expense data needed to make meaningful cost comparisons and control operating costs. In addition, field office managers will be able to use MIDLIS to schedule recurring servicing activities and follow-up activities. Automation of the HUD-held accounting systems, currently in the planning stage, will facilitate field office servicing of HUD-held projects by providing automated tracking of payments due under workout arrangements and automated delinquency printouts.

- New Servicing Procedures. The concept of "troubled" and "untroubled" project servicing will permit staff to concentrate their efforts upon the projects most in need of assistance. At present, this concept is fully operational only in the Flexible Subsidy Program, but work measurement standards, RETRS, and the operating plan have been designed to accommodate expansion of this concept to all projects in management. Less staff intensive reviews and less frequent monitoring will be required on projects which have no indications of problems. More comprehensive reviews and analyses and more frequent monitoring (e.g., monthly accounting and quarterly performance reports) will be required on financially or physically troubled projects. Further, the anticipated decentralization of responsibility for negotiating and approving workouts and other relief plans will reduce delays resulting from current multi-tiered approval processes.

- Third-Party Servicing. Recognizing that continuing efforts to trim the federal budget will limit increases in federal staff while the number of projects in management continues to increase, the Department has attempted to augment its staff resources by drawing upon the skills of third-party servicers. Examples of this technique include the following:

  -- IPA Guide. By requiring that the annual project financial statements prepared by independent accountants include not only the traditional financial schedules but also a management questionnaire assessing the owner's compliance with major HUD program requirements (e.g., restrictions on owners distributions), the Department has augmented its ability to detect deficiencies in financial controls and management performance.

  -- Flexible Subsidy Program. In the Flexible Subsidy program, routine functions of adding invoices, releasing relief funds and documenting sources and uses of relief funds have been contracted to a depository agent or bank. Thus, HUD staff is not required to become involved in the more routine aspects of project monitoring but rather are freed to concentrate their efforts on analysis of project problems and negotiation of improvement programs.

6. Improved Channels of Communications between Headquarters and Field Staff. Positive action has been taken to improve the quality and frequency of Headquarters and field office interaction. Each Region has been assigned a desk officer or contact-point within the Headquarters Office of Management and Occupancy. Instead of encouraging excessive delays in obtaining answers to pressing questions caused by not knowing who in Headquarters to call, the field can now call upon one desk officer to assemble answers to major questions on policies and procedures. In addition, field staff are now participating in Headquarters' policy planning sessions and serving as instructors in national training courses. More importantly, individuals with substantial field experience have been recruited to fill many of the top Headquarters positions which have responsibility for establishing the Department's programs and procedures.

## C. Improved Program Policies and Procedures.

The Task Force Report and other studies have criticized the Department's loan servicing procedures as passive and bureaucratic. Several studies have concluded that existing servicing procedures emphasize completion of administrative paperwork rather than the analysis and substantive monitoring which are needed to solve the problems of troubled projects. In addition, both HUD field staff and industry groups have argued that the diverse and often conflicting requirements of HUD programs restrict their ability to administer the programs effectively. To remove unnecessary requirements and to improve the effectiveness of field office servicing, the Department is attempting to standardize procedures in similar programs and to emphasize aggressive, preventive servicing. The following actions have been taken or are currently under active consideration:

1. New On-site Review Requirements and Procedures. While handbooks were changed in 1977 to require field staff to complete on-site management reviews of project operations, the format and procedures for completing these reviews were left to the field offices to develop. As a result, many offices neglected the reviews, and offices which did conduct management reviews often limited their reviews to occupancy paperwork or rent collection procedures. In the past, handbooks also permitted field offices to rely upon annual site visit reports prepared by mortgagees. Recognizing that a firsthand knowledge of project conditions and operating procedures is essential to aggressive preventive servicing, the following changes have been made in these procedures:

    - Detailed forms and procedures for conducting on-site management reviews have been prescribed. The new procedures provide for two levels of review. When normal servicing reviews of physical inspection reports, tenant comments, and annual financial statements indicate that a project is healthy, the on-site review is limited to a check of management's compliance with HUD requirements, financial controls and preventive procedures (including financial controls, rent collection procedures and monitoring of on-site staff's work). When these limited on-site reviews or other routine oversight activities indicate problems are developing, the new procedures require a more intensive, comprehensive review. The comprehensive review requires a detailed review of all aspects of project management and is designed to assist loan servicers in identifying problems, determining their underlying causes, and developing comprehensive solutions.
    - Completion of on-site management reviews is being monitored through the Department's monthly EMR and OPLAN process.
    - To facilitate timely processing of rent increases, requests for replacement reserve releases, and tenant complaints, field offices have been required to complete their own physical inspections annually on subsidized projects and every two

years on unsubsidized projects. A uniform physical inspection form has been prescribed for insured, HUD-held and HUD-owned projects.

2. Troubled Project Servicing Procedures. The Flexible Subsidy program introduced a totally new way of dealing with troubled projects. In addition to providing financial assistance, the Flexible Subsidy Program set forth detailed procedures for analyzing and resolving the problems of troubled projects. The Flexible Subsidy Handbook calls for each loan servicer in the field offices, upon discovering problems in a project, to:

- Analyze and document the project's problems and their causes;
- Determine the project's needs and abilities -- including its ability to increase cash flow, clear mortgage and other financial delinquencies, and support future debt service payments required by the current mortgage;
- Discuss the project's problems and needs with the project's owner;
- Review available tools (e.g., modification, workout, NP-LD transfer, rent increase, forclosure) and select the tool or mix of tools appropriate for that project;
- Negotiate a Management Improvement and Operating (MIO) Plan with the project's owner. (The MIO Plan is a two-part program -- Part I consists of a set of detailed procedures and a budget for day-to-day operations of the project; while Part II consists of a series of one-time actions which the project owner will take to improve the physical, financial, and management condition of the project.);
- Monitor owner compliance with the MIO Plan by reviewing monthly schedules of cash receipts and disbursements and owner's quarterly report of performance against the MIO Plan; periodic site visits are also required when the MIO Plan calls for major repair work to be completed; and
- At the end of the MIO Plan period, evaluate project conditions, determine if additional relief is necessary and, accordingly, either close out the relief program or negotiate a new MIO Plan with the owner.

Detailed forms and instructions are provided for each step in this process. Prerequisites or conditions for receiving Flexible Subsidy assistance are specified. These include: cooperation of the owner; financial contributions from profit-motivated owners; management agent and on-site procedures acceptable to HUD; and time frames for bringing the mortgage current and correcting physical deficiencies. So long as the field office can negotiate an acceptable MIO Plan and meet these conditions, the field office may select the projects to receive Flexible Subsidy and execute contracts, without a case-by-case approval of Headquarters. To assure that field offices act promptly once projects are selected for funding, the Department's operating plan sets forth time frames for completing the negotiation of the MIO Plan and implementing the relief program.

Recognizing that trouble can develop in any project, subsidized or unsubsidized, and at any stage in the project's lifecycle, this troubled project servicing process is currently being extended to cover all troubled projects. In the near future, the same in-depth analysis and monitoring will be required on all severely troubled projects -- regardless of the mortgage status or relief tools used. Specifically, the Department intends to:

- Require that an in-depth project analysis worksheet be completed in all cases of continuing default and that the projections as to the project's financial ability to cure the delinquency and support future debt service requirements be updated at the time a Notice of Election to Assign is received. Having completed this analysis prior to the date a mortgage is assigned, field offices will be prepared to take immediate action on newly assigned loans.

- Revise the format and content of workout agreements so to:

  (1) Specify the dollar amount of the monthly payment due from the owner; the payment amount will be determined through the kind of detailed income and expense analysis process introduced in the Flexible Subsidy Program; and

  (2) Require a MIO Plan whenever extensive repair work or changes in management procedures are required.

- Explore the practicability of replacing some of the existing HUD-owned forms and procedures with the MIO Plan's operating budget and improvement schedule.

3. Blending of Occupancy Program Requirements. To improve the field offices' and management agents' abilities to administer existing tenant subsidy programs, the Department will standardize the procedures for determining tenant eligibility and calculating income and rents under the various tenant subsidy programs. These changes will permit use of the same tenant application and billing procedures for all programs and should greatly reduce the current high incidence of errors in processing of tenant applications, recertifications and subsidy vouchers. Uniformity will also facilitate automation of these processes.

4. Tenant and Community Participation in Project Management. Recognizing that the cooperation and participation of tenants and the community is essential to the successful operation of a multifamily project, Housing has published regulations providing for tenant participation in the management of multifamily subsidized housing projects. Section 402 tenant input regulations and the Flexible Subsidy program regulations require owners of insured and HUD-held projects to give tenants an opportunity to comment upon major actions that would affect the day-to-day operation of the project (e.g., change in management agents or owners; major physical improvement programs; and Flexible Subsidy MIO Plans). Part 290 regulations give tenants in HUD-owned projects similar opportunities for comment and provide for tenant input on the repair, disposition and future ownership of projects.

   In addition, HUD is working with several housing research groups -- including Citizens Housing and Planning Association (CHPA) and the National Housing Law Project at Berkeley — to explore the feasibility of transferring HUD-owned projects to various forms of resident controlled ownership. HUD is also encouraging investors who purchase projects from non-profit groups to provide the non-profit sellers an opportunity to participate in the future management of the project when it appears that such participation would be beneficial. Recognizing the benefits of resident and community involvement, many investors already routinely retain non-profit groups as co-general partners or advisory board members.

5. Improvements in HUD-Held Accounting Procedures Planned. The current HUD-held accounting system is not providing field offices with the timely financial information required to monitor HUD-held mortgages. Housing and the Office of Finance and Accounting (OFA) have agreed that the existing system and procedures should be improved and automated. The Department's goal is to obtain an accounting system that provides for automated tracking of payments due under workout agreements, monthly delinquency reports, annual escrow analyses and annual account statements. Housing and OFA will also evaluate the effectiveness of the current billing process and, if necessary, consider alternative payment systems.

6. Preservation of Low and Moderate Income Nature of Projects. With the current appreciation in real estate values and the prediction of a housing shortage for the 1980's, many believe that owners will wish to prepay the mortgages on subsidized projects and convert them to uses other than low and moderately priced rentals. While mortgage prepayment prohibitions and the tax recapture penalties have discouraged such sales in the past, recent developments have made it possible for owners to circumvent prepayment restrictions, and it appears that, in at least some cases, sales profits would be more than sufficient to offset recapture penalties.

   To assure the continued availability of these projects as low-income housing, the Department:

   - Has issued regulations requiring that future subsidy contracts be written for 20-year rather than 5-year terms;

   - Is considering requiring owners to agree, as a condition of receiving financial relief (workouts, flexible subsidy, etc), to extend the period of time during which the project will remain available for low- and moderate-income families; and

   - Is exploring ways in which the Department could: (a) restrict the owners' ability to circumvent existing prepayment prohibitions; and (b) provide an exit mechanism that will either encourage owners who wish to get out of projects when a subsidy contract or prepayment prohibition terminates to reinvest in other subsidized housing, or to assure that the existing projects will continue to serve low- and moderate-income families.

7. Improved Leverage. The Department is exploring additional ways of improving its negotiating position and increasing its leverage to carry out the legislative mandate to protect the FHA insurance fund and preserve the physical condition and affordability of these projects. Major actions under consideration are discussed below.

   - Expand use of the Department's previous participation (2530) clearance and Debarment Processes. The Department will explore requiring management agents to obtain 2530 clearance prior to obtaining management contracts on existing as well as newly constructed projects. It will also instruct field offices to initiate debarment action or denial of previous participation clearance when owners or agents refuse to submit required monthly and annual financial statements or to make books available to HUD auditors.

   - Take action against CPAs and IPAs who submit audited financial statements that do not comply with the Inspector General's audit handbook. Action could include referral to state regulatory boards; debarment from future participation in HUD programs; and, in the case of failure to identify illegal disbursements, judicial suit for damages.

- Expedite Foreclosure Process. To reduce delays and make foreclosure and consequent recapture penalties a real threat to uncooperative owners, HUD is undertaking two efforts. First, it is working to identify changes in internal processing procedures which could reduce delays. As a second, long-term effort, the Department is considering again requesting Congress -- which rejected the Department's 1978 initiative -- to preempt HUD from the "cram-down" provisions of the federal bankruptcy laws and to establish a uniform foreclosure process for HUD subsidized projects.

- Notify IRS of foreclosures completed. A recent IRS survey found that many principals involved in ownership entities against which the Department has foreclosed have not reported the recapture of excess depreciation on their income tax returns. To assure that foreclosure does have financial consequences for an owner, HUD has developed and implemented a procedure for supplying IRS with the names of all principals involved in foreclosures so that IRS can impose appropriate recapture penalties.

- Explore ways of reducing tax benefits of delinquent, uncooperative project owners. At present, owners who refuse to make mortgage payments or to negotiate meaningful workout agreements continue to receive income tax deductions from accrual of unpaid interest and service charges. To improve its leverage for negotiating workouts and curing delinquencies, the Department intends to explore ways of reducing tax benefits and imposing financial penalties prior to the date foreclosure is completed.

8. Improved Handbook Instructions. An aspect of the management environment which has presented problems in the past is the clarity and comprehensiveness of instructions from Headquarters to the field. As in other management areas, the Flexible Subsidy program is a model for Housing's new approach to handbooks and policy statements. The Flexible Subsidy handbook provides detailed forms and instructions for each stage of processing, and procedures are explained through several mediums -- flow charts, narratives, figures, control logs, and so forth. While the handbook maps out in detail the decision process, procedures, and relevant policy criteria for administering the program, significant discretion on individual project improvement decisions is left to field managers who are then held accountable.

## D. New Program Tools and Resources.

As the Task Force noted, even the best management systems and program procedures cannot, by themselves, alleviate the problems of troubled projects. The Task Force recommended that the Department develop new tools and resources which would enable it to provide financial relief to deserving projects and to extract needed management improvements and cash concessions from project owners. The Department has acted upon that recommendation. Additional tools and resources have been created and more are currently being developed. Some of these tools and resources are discussed below:

1. Flexible Subsidy Program. Implemented in August 1978, the Flexible Subsidy Program is a major new servicing tool. Unlike existing

subsidies each of which can deal with only a part of a project's total needs, Flexible Subsidy is capable of addressing nearly all of a project's needs. Flexible Subsidy provides immediate cash for correction of deferred maintenance and replacements, financial deficiencies, and replacement reserve and operating deficits. Because both the initial allocation and the continued receipt of Flexible Subsidy assistance are conditioned upon a project owner's ability to provide for management satisfactory to HUD, the loan servicer responsible for the project is able to extract changes in management agent or on-site procedures necessary to promote the long-term viability of the project. While both insured and HUD-held projects are eligible for Flexible Subsidy, the Department is giving priority consideration, this year, to insured projects in order to avoid additional claims against the mortgage insurance funds.

2. Repair of HUD-Owned Properties. To correct the substandard living conditions existing in HUD-owned projects, the Department decided in 1978 to use the FHA Insurance Funds to repair HUD-owned properties. In April 1978, HUD identified, office by office, the need for immediate repairs in 21,000 units affecting nearly 100,000 tenants and immediately began repairs on these units.

3. New Rent and Disposition Rules for HUD-Owned Properties. To avoid unnecessary displacement of lower-income tenants and to ensure that HUD-owned projects remain affordable by low-income families both during the period of HUD ownership and following resale to private owners, the Department has published new regulations. The new Section 290 regulations provide that: (a) eligible lower-income tenants pay only what they would be paying if a Section 8 subsidy were available; (b) formerly subsidized and unsubsidized projects now serving lower-income tenants be sold with subsidy unless the field office determines that additional subsidized housing is not needed in the community; and (c) displacement benefits be paid to eligible lower-income tenants who are forced to move by disposition of a HUD-owned project or by repairs undertaken while the project is HUD-owned.

4. Improved Management in HUD-Owned Properties. One of the Task Force's major findings was that projects deteriorated rapidly once HUD assumed ownership. This deterioration was attributed, in part, to HUD's policy of awarding management contracts to the lowest bidder. The low-bid approach often resulted in selection of the least competent of those bidding. The Department has modified its procedures for selecting agents and now permits field offices to use a two-step process which considers qualifications of agents first, and then the dollar amount of their bids. In step one of the new process, a field office accepts proposals detailing agents' qualifications and plans for correcting a project's problems; no bids are included. The field office reviews all proposals and determines which are acceptable. In step two, procurement procedures are used to solicit bids only from agents who submitted acceptable proposals in step 1. The contract is then awarded to the lowest qualified bidder.

   Major changes in the on-site recordkeeping and HUD oversight procedures for HUD-owned projects are also planned. The Department hopes to replace the current piecemeal purchase order system with a project-based accounting system similar to that required on insured and HUD-held projects and a budget-based planning and monitoring system similar to that introduced in the Flexible Subsidy Program. Implementation of such changes will not only provide tighter control over project operations but may also increase the number of management agents willing to operate HUD-owned projects because agents already familiar with insured and

HUD-held project management requirements would no longer need to incur additional costs for training staff on procedures used only on a limited number of HUD-owned projects.

5. Partial Payment of Claims. As another part of its effort to reduce claims against the mortgage insurance funds, Housing is implementing the partial payment of claims program authorized in the 1978 Housing and Community Development Amendments. Under this program, the Secretary may request a mortgagee, in-lieu of assigning a defaulted mortgage on a subsidized project and filing a claim for the full mortgage balance, to file a claim for only part of the mortgage balance, recast the balance over the remaining term of the mortgage, and continue to hold the reduced, insured mortgage. The mortgagee will hold only that portion of the mortgage on which the debt service can be supported by project rents. The Department will hold a second mortgage for the amount of the claim paid.

6. Non-Profit to Limited Dividend Ownership Transfers. Equity contributions of profit-motivated buyers provide another source of cash for meeting the needs of troubled projects. The Department is encouraging such transfers when non-profit owners have abdicated management responsibility and an immediate cash infusion is needed to correct physical and financial deficiencies. Proposed regulations, published in September 1979, will provide criteria and guidelines for field offices to follow in negotiating the terms of these transfers and should eliminate the abuses found in some earlier transfers.

## RECENT HUD POLICY CHANGES

We have put into place a process for changing those conditions. Although the report submitted by HUD today sets forth more comprehensively the changes that have been made, I would like to mention a few of them.

One of the most important policy changes made by this administration was the decision to preserve as low-income housing the multimillion-dollar housing investment represented by the Department's subsidized and formerly subsidized troubled projects.

We decided to put our own house in order first. To accomplish this, HUD increased its field management staff by 356 positions, from 793 in fiscal year 1977 to 1,150 for this year. Nevertheless, the Department is still now staffed below its minimum work measurement standards despite the increase I mentioned.

## IMPROVEMENTS IN HUD-OWNED INVENTORY

With respect to HUD-owned properties, we made the following important decisions:

First, we decided to repair all properties which the Department owned to insure that tenants in those projects were provided good and decent housing.

Second, in May of 1977, HUD directed that no tenant living in a formerly subsidized project should be required to pay more than 25 percent of income for rent.

Third, to prevent displacement of low- and moderate-income families after the sale of HUD-owned projects, with Congress approval, HUD made section 8 subsidies available for low- and moderate-income tenants who remained in the projects.

These initial policy decisions were the first steps we took to deal with a set of problems affecting projects, families, and neighborhoods across the country. Taken together, these policies were designed to respond to recommendations made by tenants, project owners and managers, professional housing associations, private consultants, by this committee, and the Congress in the Housing and Community Development Act of 1978.

We recognized that more had to be done, and more was done.

## REORGANIZATION OF CENTRAL OFFICE

To create clear lines of accountability for the implementation of these new policies, the housing function in central office was reorganized. The Offices of Loan Management and Property Disposition which had emphasized the mechanical aspects of servicing loans and disposing of property were eliminated. In their place, the Office of Management and Occupancy and the Office of Financing and Preservation were established in November 1978.

The Office of Management and Occupancy was given the task of developing and implementing new HUD policies and procedures emphasizing quality property management; aggressive, preventive servicing; sound project problem analysis; comprehensive problem resolution; and effective project monitoring, while the Office of Financing and Preservation was given the responsibility of applying these new policies to HUD's troubled assigned and HUD-owned projects.

## ESTABLISHING AND MONITORING MANAGEMENT GOALS

For the first time, management goals were established in the Department's management system. The most important of these called for placing 90 percent of all HUD-held projects under an approved plan by the end of the 1979 fiscal year.

Although that goal was not reached, the Department made substantial progress toward it—increasing the percent of major projects under a plan from 62 percent at the beginning of the year to 80 percent by the end of the year. What is important is that we watched what we were doing carefully.

## FLEXIBLE SUBSIDY PROGRAM

The most important corrective measure, however, was the flexible subsidy program, which HUD requested from the Congress in 1978 and received authority to implement with the housing amendments of that year.

This program allows a relatively small investment of additional Federal funds to save a significant number of projects from assignment and foreclosure resulting in substantial savings to the Federal Government.

The flexible subsidy program is representative of the important changes which have been made in the Department's loan servicing and project monitoring efforts and the new attitude being created at HUD.

### COMPREHENSIVE AND PREVENTIVE SERVICING

It is a totally new way of approaching troubled projects. It requires identification and thorough analysis of a project's financial, physical, management, and tenant problems; and proposal of a comprehensive solution—including a financial contribution from the owner and an agreement to improve the project's management, if needed. In addition, loan servicers must closely monitor the implementation of relief plans and continuously evaluate progress toward solving project problems.

Although these aggressive, preventive servicing procedures were developed for the flexible subsidy program, they are presently being extended to cover all troubled projects regardless of the method of dealing with the project.

All of the policy changes we have described were responsive to the more than 800 pages of testimony on distressed projects taken by the chairman's committee in April and October 1977. The changes are also responsive to the Housing and Community Development Amendments of 1978.

### SIGNIFICANCE OF POLICY CHANGES

These policy changes marked a significant departure from the policies of previous administrations and signaled the beginning of a new approach by HUD toward its management responsibilities for troubled projects.

We do not mean to suggest that there are not still serious difficulties managing and improving the projects in question. We want to underscore, however, that with the help of the committee and the entire Congress, serious efforts were made to correct problems that were left unattended for nearly a decade.

To put it simply, HUD has worked for some 30 months to define the problem, to develop policy responses, and to institutionalize these responses in the daily management practices of the Department.

We have not yet accomplished everything we set out to do, but we have put in place the foundation upon which we can build better management structure in the months and years ahead. That is the task to which I am committed. It is through this diligent effort to improve our management of our housing programs that we will go a long way to preventing the sort of problems encountered at Clifton Terrace. With that in mind, I would like to ask Assistant Secretary Simons to discuss the particulars of that case.

Senator PROXMIRE. Before we hear from Secretary Simons, I want to thank you very much. The statement that you have given us is pretty much word for word what Pat Harris sent up as her statement except the part I read into the record regarding her personal feelings about not being invited to appear.

Secretary LANDRIEU. Mr. Chairman, if I may provide an explanation, as we prepared our testimony, it was assumed by us that I would make a brief statement, an introduction on behalf of the Department and that Secretary Harris would then present a statement. When it came to our attention that she would not be testifying today, I adopted the entire statement and presented it to the committee. Mrs. Harris felt it necessary, in light of the circumstances, to write the chairman the letter and to release the testimony which she previously had been prepared to give. It is a matter over which we had no control. I wish it hadn't happened that way, but nevertheless that is the way it came out.

## STATEMENT OF ASSISTANT SECRETARY, HOUSING AND URBAN DEVELOPMENT

Senator PROXMIRE. Secretary Simons, you have both a summary and a full statement. Do you want the full statement printed in full in the record?

Mr. SIMONS. The summary, Mr. Chairman, is the finish of my testimony. I would like to present the Clifton Terrace testimony in detail and Ms. Melkonian will present part and I will summarize at the end.

Senator PROXMIRE. Your initial statement is 18 pages long. We have a number of questions.

Mr. SIMONS. I think, Mr. Chairman, that you will find the testimony which I will give today on Clifton Terrace is consistent with the constructive attitude you have set for this hearing. I think it is very important that it be set forth in detail and I think it will answer many of the questions you will raise.

Today the Department has been called upon to account for its actions in connection with the Clifton Terrace project.

### P.I. PROPERTIES UNDER EXAMINATION

Before discussing this matter, it is important to note that the questions concerning possible violation of law by individuals associated with Pride's real estate arm, P.I. Properties, Inc., the former owner of Clifton Terrace, have been under examination by the U.S. attorney's office since the matter was referred by the Department to the Justice Department in June of this year by HUD.

It is our strong desire in testifying today to avoid any comments that might prejudice that case. Nothing in our statement should be construed to suggest any conclusion regarding the guilt or innocence of any individual involved.

With that in mind, we will describe the record of HUD's actions and knowledge with respect to P.I. Properties prior to the foreclosure action in June 1978.

In reviewing these events, the Department has examined two questions closely:

First, why did it fail to find the alleged embezzlement during the period of P.I. Properties' ownership of Clifton Terrace? And, perhaps a more important question for HUD, in the absence of knowledge of the alleged embezzlement, were the Department's actions proper?

First, it can be unequivocally stated that at no time during P.I. Properties' ownership of Clifton Terrace did HUD have evidence of the alleged embezzlement. Not until June of this year, at which time HUD's Inspector General turned over certain results of its investigation into the activities of P.I. Properties at the project to the Justice Department, did HUD have such evidence.

The record reflects the struggle by the area office and later the central office to resolve the problems of a severely troubled project. The record will reflect how mistakes that were made by the Department compounded themselves and a web of confusion and contradiction was spun and exploited by the owner and used perversely to blame HUD for the owner's own failures. The record will also reflect the effort of the Department to isolate the owner's obligations and to build an unimpeachable record on which HUD could foreclose swiftly. HUD made this effort because it knew that foreclosure would be, and was, hotly contested by Pride.

Finally, the record will show that in October 1978, after foreclosure, HUD's Inspector General continued its investigation into the activities of Pride at Clifton Terrace and the results of that inquiry led to the grand jury investigation which is pending today.

The record of the Department's transactions with Pride begins in June 1975 when, after a year of trial management which was not entirely satisfactory, HUD sold Clifton Terrace to Pride's real estate arm, P.I. Properties.

## NEGOTIATED SALE OF CLIFTON TERRACE

The circumstances of the sale were unusual in that HUD had rarely used the technique of a negotiated sale, except with public bodies. However, this method of disposition, by itself, is neither improper nor without merit. In fact, the Congress specifically recognized the Department's authority in the Housing and Community Development Act of 1978 to make this technique available.

In the case of Clifton Terrace, however, this technique was not properly used.

Although the reasons given for the sale to this organization were its reputed ability to work with tenants and to provide social services, the tenants had no opportunity to comment on the proposed sale. Their comments might have influenced the decision to sell to Pride in the first place. This could not happen today.

Under the present part 290 of the Department's regulations governing the disposition of multifamily properties, HUD specifically requires that tenant comments be solicited in connection with any proposed disposition of a multifamily project. The law also requires this as a result of the 1978 Housing Amendments. The lack of opportunity for public comment on the qualifications of Pride to do the job was an essential missing ingredient in the 1975 disposition of Clifton Terrace. HUD agrees with the tenants that they are important participants in the sale of their homes and deserve the right to be heard. They now have that right.

The plan to sell Clifton Terrace on a negotiated basis did not pass without skeptical congressional comment. At the 1974 hearings in the House of Representatives on HUD appropriations, former Secretary Lynn and former Assistant Secretary Crawford were questioned closely about the arrangement HUD was making with Pride, and members of that committee were highly skeptical about Pride's record of accomplishment.

Then Assistant Secretary Crawford stated at that time—

Our problems around the country are duplicating the kind of situation we have in Clifton Terrace. What we are doing is merely demonstrating with Pride. We are not saying this is a panacea for all our problems, but this is just one more innovation to see if it makes sense to turn over a problem-ridden project to an inner-city organization that has proven its ability to do something in a given area.

## PRIDE'S REPUTATION AT TIME OF SALE

In response to a request for documentation of accomplishments, Mr. Crawford listed the reputed accomplishments of Pride with other Federal agencies; the District of Columbia government; and private enterprise, including General Motors, Ford Motor Co., J. C. Penney & Co., American Oil Co., British Petroleum, and the American University.

In addition, Mr. Crawford listed the recognition of Mayor Walter Washington, the Congressional Black Caucus, and the Governors of 23 States who had supposedly approached Pride for help in starting another Pride for them.

It was in light of this recognition and support that the Washington Post hailed the transfer of Clifton Terrace to Pride in its November 1975 editorial entitled "A Model for the Nation." The Post stated:

> Despite all its troubles, Clifton Terrace has proven that the rehabilitation of deteriorated and defaulted inner-city housing can be made to work * * * that good, tough management can keep inner-city housing a decent place to live * * *. It stands, in short, as a shining example for others to follow.

Having made the decision to go ahead with the transfer to Pride, however, the Department failed to pin down properly the terms of the transfer.

A major question raised by this committee was, Why did HUD set the purchase price at $820,400 when it had a fair market value estimated at approximately $400,000 higher at the time?

## WRITEDOWN OF PURCHASE PRICE

The reasoning was that with a mortgage of $820,400, given the rent increases planned for the project, the project's income would be sufficient to meet operating expenses and debt service and rents could be set at a level affordable by low-income tenants without the need for additional Federal subsidies. Therefore, even though the original cost of the project was $4.4 million, which the Government paid out under the insurance claim, the total Federal investment in 285 units of low-income housing was approximately $15,500 per unit, with no additional subsidies, and a cost amounting to approximately one-third the cost of housing built today.

This is a method, known as a writedown, which can be used in selling properties that HUD owns that eliminates the need for long-term tenant subsidies which are very expensive to the Federal Government. The chairman of this committee, among others, recognized the validity of this technique when he stated in the October 1977 hearing on HUD-distressed properties: "From the standpoint of the taxpayer and from the standpoint of doing a job as efficiently and at as low a cost as possible, writedown is the way to go."

HUD is obligated by law to maintain the low-income character of

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formerly subsidized projects upon sale and it does so by assessing what method of disposition is least costly to the Federal Government. The use of writedowns can be and should be used appropriately to accomplish this result, as suggested in the report of this committee's investigative staff.

### LACK OF SPECIFICITY IN CONDITIONS OF SALE

Although the sale price of Clifton Terrace may have been properly established for this purpose, other terms and conditions were not so precisely determined.

For example, the regulatory agreement governing the operation of the project and establishing its legal relationship to HUD was not tailored to the special needs of this demonstration project. The standard regulatory agreement for unsubsidized projects was used instead. This contained no prohibition against prepayment of the mortgage and did not require the owner to maintain the project solely for use by lower income residents, nor did it give HUD any special right to step in and take possession if things went wrong.

Another problem was the agreement with the purchaser on the condition of the property. Although HUD sold the property as is, HUD had replaced the roofs prior to sale, and when these roofs proved defective, HUD, not the owner, had to pursue its rights under the warranty agreement with the roofer. This was an endless source of problems from the beginning and a major cause of HUD being on the defensive with this owner. From the time of the transfer, the owner claimed that water damage to apartments from the defective roofs deprived the project of rental income and caused high maintenance costs which made it impossible for the project to meet its mortgage payments.

The lack of specificity in the sale agreement also permitted the owner to raise arguments that rent increases, debt moratoriums, and other oral promises had supposedly been made and HUD had reneged.

Former Area Director Clay, in his letter to me on December 16, 1977, reviewed the problems with the owner caused by the lack of specificity in the sale agreement:

> This Department agreed to provide certain repairs to Clifton Terrace prior to the sale. Because these agreements were general and often not in writing, this Office and the buyer have been constantly at odds as to the meaning of these agreements and as to HUD's continuing responsibility under them. The buyer continues to claim that assistance is owed by HUD and that its inability to make its required mortgage payments is due at least partially to lack of services agreed to by HUD.

While HUD insisted throughout the period of Pride's ownership that Pride meet HUD requirements for proper financial reporting and other requirements, Pride continued to insist that its problems were the result of HUD failures.

### INSPECTOR GENERAL AUDIT REPORT

In January 1977, after repeated HUD demands for more complete financial reformation had been put off with promises by the owner that it was trying to perform, the area office requested a regional inspector general audit of the project.

Prior to the completion of the audit report, on April 26, 1977, the

Director of the Office of Loan Management, Mr. Fred Pfaender, sent me a background memo on Clifton Terrace, stating that the mortgage had been "in a serious state of default for many months." Mr. Pfaender further reported that, "A lack of financial reporting by the owner has precluded us from judging whether the default is a result of mismanagement." He noted that, "There is, however, a suspicion that owner/management may have misused project income" and that an interim audit report would be available soon.

In early May 1977, after receiving the draft findings from the May audit, Mr. Pfaender sent a report to me summarizing the findings and recommendations of the audit. He wrote that, "One must conclude that the project has been improperly managed, and the auditors recommend that the mortgagor engage the services of a HUD-approved management agent." The report further stated that the Office of Loan Management was awaiting the District of Columbia area office recommendation that would follow the final audit report.

The audit report was issued on May 27, 1977. The general finding produced by the audit was that the mortgagor did not provide for the proper financial management of the project. The regional inspector general for audit found that the books and records were incomplete, inaccurate or, in some instances, unavailable. The specific findings were: Absence of annual audited financial statements; inadequate maintenance of financial records; lack of internal cash control; costs charged to the project which were properly chargeable to other properties; unnecessary costs charged to the project; no evidence of solicitation of bids; and inadequate documentation of project costs.

At the same time, the examples of misuse of income given to support the findings were improper expenditures for a Christmas party, Thanksgiving baskets, and other such items, amounting to over $4,000, which the owner defended as "social services and activities enjoyed primarily by the tenants * * * an integral part of the management plan."

### FORECLOSURE RECOMMENDATION

On June 15, members of the staff of the Office of Loan Management met with the area office director to discuss servicing of the project; and, although the area director, Mr. Clay, actually recommended foreclosure on June 20, 1977, Mr. Pfaender reported the results of his staff's meeting to me on June 22, 1977.

Mr. Pfaender's report of that meeting indicated that the area office director was reluctant to recommend foreclosure because of the confused and complicated nature of the sale and alleged oral commitments relating to the sale and actions which the Department was to have taken as part of the transaction.

The area director had reported that the audit findings were being addressed, and that he, Director Clay, would require P.I. Properties to hire a qualified property manager. No independent recommendations or findings were made by the Office of Loan Management in its report, although Mr. Pfaender did state that:

> Unless the differences between HUD and P.I. Properties can be ameliorated with dispatch, I see no way of reinstating the mortgage let alone providing decent housing for the tenants at Clifton Terrace.

Although no date can be pinpointed, it was during this period in late June 1977 that Mr. Pfaender and Mr. Weisbach, a member of Mr. Pfaender's staff, met with me and discussed their concerns with the operation of the project. I asked Mr. Pfaender to prepare an abstract to the Secretary on Clifton Terrace.

In the abstract prepared by Mr. Pfaender, he presented the area director's opinion that the lack of responsible and efficient management indicates that foreclosure would be in the best interest of the Secretary, as well as two additional options to foreclosure; one, accepting a deed from P.I. Properties; or two, a provisional workout arrangement to bring the mortgage current with the possible condition that the Department take control of the property in the interim.

The abstract contained no information or analysis to supplement the findings of the May audit report. Mr. Pfaender did not take a specific position recommending foreclosure. It should be noted that the Director of the Office of Loan Management had the authority to initiate foreclosure without any additional concurrence from any other official of the Department.

### REASONS FOR WITHDRAWAL OF FORECLOSURE RECOMMENDATION

There has been much discussion of the reasons why HUD did not proceed with foreclosure in June 1977. In retrospect, it is my opinion that, in absence of both knowledge and evidence of the alleged embezzlement, foreclosure was not necessarily the best option at that time.

In discussing the reasons for the withdrawal of his foreclosure recommendation, Mr. Clay stated later to me in his letter of December 16, 1977, that when he was asked for assurances that the Department has taken all possible steps to live up to our obligations under the contract of sale, he could not provide those assurances and that there were problems with the project and the transaction with P.I. Properties that were not the fault of the owner.

In light of these doubts and concerns, it was reasonable for Mr. Clay to reconsider his recommendation and choose to continue to work with the owner to resolve the problems surrounding the project.

During July 1977 P.I. Properties sent a number of memoranda to the District of Columbia area office indicating specific steps being taken to respond to the audit findings and correct the management deficiencies at Clifton Terrace, including the submission of copies of checks drawn to the Clifton Terrace account for reimbursement of various items which the audit had found to be improper project expenses.

On August 3, after five personal meetings with the owner, the area director reported to me that he was withdrawing his foreclosure recommendation pending the outcome of steps being taken to clear the audit and improve management. The director stated that, "It is my judgment that we will be able to stabilize this project and move toward curing the default in the next 90 days."

On August 12, 1977, the Director of the Office of Loan Management prepared a memo, drafted by Mr. Weisbach, for me to send to Mr. Joseph Burstein, counselor to the Secretary. Mr. Burstein had been designated to represent the Secretary in requests for meetings on projects in the District of Columbia. The memo forwarded the area office director's request to hold the foreclosure in abeyance. That memo suggested that substantial progress had been made in turning around the project and endorsed the request to suspend foreclosure stating explicitly that we have no problem with the director's request for additional time to implement the activities being undertaken to place the project in a viable position. The only concern expressed was whether the rent structure at Clifton Terrace could be made to support both debt service and expenses necessary to provide decent housing for the tenants.

On August 15, 1977, Mr. Pfaender informed Marilyn Melkonian, then consultant to me, about the area director's August 3 memorandum holding foreclosure in abeyance and transmitted previous correspondence prepared by his office on the Clifton Terrace issue. He also reported the area director's optimism that project operations can be stabilized within the next 90 days and we can then address the monumental task of curing the mortgage default. Mr. Pfaender did not contradict this optimistic prediction, nor did he supply any additional information or findings.

The May 1977 audit was the working document used by the area office and the central office through the end of 1977 to attempt to bring the project into line and to obtain the compliance of the owner with HUD requirements. In the absence of any evidence of embezzlement, the District of Columbia area office struggled to work with this owner, who forcefully represented that the problems of the project were not of her own making.

### AREA OFFICE SEEKS DIRECTION

On December 16, 1977, the District of Columbia area office director wrote to me seeking guidance and direction in dealing with this project. He reported that after 7 months of intense personal and staff involvement he was prepared to submit a recommendation on the project. The recommendation specified the need to restructure completely HUD's relationship to the project: One, a new regulatory agreement was essential, canceling out all previous agreements; two, the owner's obligation to maintain 52 units at a below-market rent had to be reevaluated; three, headquarters should take over servicing; and four, he had informed the owner that new management was required at the project immediately.

He also reported that progress had been made in closing the audit findings; that all expenses are either valid or we have requested reimbursements, which have been made by the owner. He stated: "Serious audit and investigation findings are closed or near closure; reimbursements have been made and financial statements are almost ready for a full audit."

Foreclosure was still an option and the long-term success of the project seemed impossible without major changes. At this point, Deputy Assistant Secretary Melkonian entered into a process to resolve the Clifton Terrace situation, and I will ask her to describe the events from this point forward.

Senator PROXMIRE. Go right ahead, Secretary Melkonian.

## MULTIFAMILY HOUSING PROGRAMS, HOUSING AND URBAN DEVELOPMENT

Ms. MELKONIAN. In response to the area office request to Mr. Simons on December 16, 1977, direct negotiations over the future of Clifton Terrace were undertaken with the owner.

After reviewing the record at the end of 1977, it was clear that firm action was necessary either to get new management or to get the owner out of the project through foreclosure.

A proposal by the owner in December 1977 to use Clifton as a further demonstration for a plan she called a national demonstration urban housing management laboratory, supposedly supported by the District of Columbia government, was rejected.

The owner continued to claim that the project was experiencing high maintenance costs because of rehab problems and vandalism; that defective roofs were causing a severe loss of rental income; that HUD had failed to honor oral agreements made at the time of the sale for rent increases; a debt service moratorium and payment of certain bills; that HUD had failed to grant proper requests for rent increases; and that 52 units in the project were required to be rented on a subsidized basis without subsidy.

### ACTION TO ESTABLISH A CLEAR ADMINISTRATIVE RECORD

A plan was developed to deal with the owner which had the dual purpose of changing management and getting financial information if the owner cooperated, or, if the owner did not cooperate, of eliminating a confused record. In our view, this record had the potential of tying the project up in endless legal battles over questions of fact. If this happened, HUD would have no control over the property for an indefinite period of time.

HUD had a good reason to fear lengthy legal battles. Many foreclosure actions brought by the Department against owners on facts and under circumstances that would appear to give the Government the indisputable right to possession of the property have been litigated endlessly.

One case, for example, has been in litigation for 11 years. HUD faced a particularly difficult jurisdiction in the U.S. District Court for the District of Columbia which decided the *Kent Farms* case. In that case, the court acknowledged that HUD was tolerant, forebearing, and endlessly patient in negotiating a workout with the mortgagor. Even so, the court enjoined the foreclosure because the record of the administrative decison did not show that foreclosure would further national housing policy. This is a case where a 221(d)(3) project was almost $800,000 in arrears on its mortgage. The court emphasized the need for an adequate administrative record.

An additional fear was that the owner, who had shown an amazing ability to pyramid enterprises, would find a way to refinance the project and get HUD out of the picture completely, resulting in the loss of this important low-income housing resource.

In an attempt to avoid disputes over questions of fact which might prevent HUD from foreclosing swiftly if the owner did not comply with

HUD requirements, a four-point agreement was negotiated between Mrs. Treadwell and me. This agreement required the owner to provide a certified financial statement for fiscal year 1977 and to obtain new professional management at the project by June 1978. On its part, HUD would undertake a physical survey of the project and assess whether or not section 8 subsidies should be made available.

### HUD INITIATES FORECLOSURE

When the owner did not comply with these requirements, HUD initiated foreclosure in June 1978. Mrs. Treadwell requested that the Department reconsider this decision. That request was denied. The owner was tenacious in her efforts to retain control of the property and sued the Department to enjoin the foreclosure. The U.S. court of appeals upheld the foreclosure decision on August 22, 1978, and HUD took immediate possession of the property, impounding books and records.

At my direction, the area office requested that the Inspector General continue its investigations into P.I. Properties, Inc., activities at Clifton Terrace. This resulted in certain evidence of possible criminal activity being provided to the Department of Justice in June 1979.

Since foreclosure, HUD has begun the painstaking process of restoring the sound operation of Clifton Terrace for the people who live there, in cooperation with them. All operating systems of the project have been restored to working order; new management was installed on October 1, 1979, using HUD's two-step procedure which required that the management agent be qualified before accepting the low bid. We believe that the efforts of the Department, this time, will lead to Clifton Terrace as decent housing and it intends to fulfill that promise.

Senator PROXMIRE. Thank you, Ms. Melkonian.

Secretary Landrieu, with regard to the first question I am going to ask you, I don't expect you to know the details of what happened in 1974. I just wanted to know if the policies in effect at that time are still being followed or not.

According to the Washington Post, back in March of 1974, Assistant Secretary Crawford told HUD's District of Columbia area office to reject any bids to manage the Clifton Terrace property—this was before P.I. took it over—because he planned to negotiate the deal himself privately. I wonder if that kind of negotiation is permitted by HUD regulations?

### SUMMARY STATEMENT OF LAWRENCE B. SIMONS

Mr. SIMONS. Mr. Chairman, I will be happy to answer that. I would like to finish my statement.

Senator PROXMIRE. I beg your pardon, I thought you were finished.

This is the summary statement that follows your regular statement? That is the first time I have ever seen a witness present a double statement.

Mr. SIMONS. In order to give the committee the full benefit of all the facts and policies concerned and the issues involved here, it was very important to present it in this way. In reviewing the events leading to the foreclosure of Clifton Terrace, what were the weaknesses that caused HUD to fail to discover the alleged fraud while P.I. Properties owned the project?

The review of monthly accounting statement and the Inspector General's limited audit failed to discover the alleged embezzlement and this is clearly an unsatisfactory result.

The Department does not seek to be excused for this result, but I ask that the following be considered.

There may have been a deliberate, skillful, and calculated effort to deceive and defraud the Government and the tenants, whose rent moneys were allegedly stolen. The bookkeeper who spent over 200 hours detailing allegations of embezzlement for reporters of the Washington Post never provided such information to HUD loan servicers or auditors. Her reported comments indicate that she was involved in supplying this allegedly false documentation to the Federal Government on a regular basis.

In spite of this, the Government did pursue the investigation on its own initiative; did discover and refer evidence of possible fraud to the Justice Department in June 1979, not after reading it in the newspapers.

It should also be noted that between 1975 and 1978, the caseload per servicer in the District of Columbia area office was approximately 100 cases per servicer.

The Department did not follow up properly on what was, admittedly, a limited audit in May 1977. It would appear from the testimony taken by this committee on November 13, that Department personnel failed to follow up on their own misgivings about the findings of the auditors.

It must be emphasized that, at all times, Department personnel were not only free to express their views, but had the duty and obligations to act on their beliefs if they thought that project income was being improperly diverted. They had the duty and authority to recommend foreclosure and to set forth any findings of fraud at the project, in writing, which they never did. They had the duty, the authority, and the responsibility under HUD regulations to pursue their concerns independently with the Inspector General, if they thought their concerns were being ignored, which they never did. They had the duty and the authority to demand a more thorough audit, which they never did. No one was ever removed from the case, or in any way inhibited or restricted from acting on the case. Any statement or suggestion to the contrary, whether made by this committee or in newspaper reports, is simply not true.

Prior to the results of the second audit, the Department had no reason to believe that the information it was receiving from the project was fraudulent or that the principals of the owner may have been betraying the public purposes of their organization.

The Department acted in good faith and in so acting reflected the faith that the Washington community had placed in Pride—an organization in which many people, many public and private agencies and businesses, a newspaper, and the taxpayers invested hope, as well as hard-earned dollars. No one can or should be made the scapegoat for the conduct of these individuals.

HUD has made many mistakes in the past; it will make mistakes in the future. No large undertaking, whether public or private, can be free of error or free of individuals who will pervert and convert the good will of others to their own advantage. This committee, the Congress, HUD, and the taxpayers can be proud of their accomplishments in housing. The crimes of any individuals committed along the path toward a decent home for every American pale in the light of those accomplishments.

For its part, HUD has learned from this experience; it has tightened its procedures; improved its oversight and monitoring and its record in this regard is placed before you today. HUD will continue, with renewed vigor, to improve its programs. It will also continue to take risks in involving new participants in its programs. We hope that we will have the help and support of this committee now, as in the past, and the continued help and support of the American people.

### CIRCUMSTANCES FOR NEGOTIATING MANAGEMENT

May I respond to the question which was asked: Whether or not a negotiated sale could take place under the present regulations?

Senator PROXMIRE. Negotiated management.

Mr. SIMONS. Negotiated management may take place under certain circumstances, and it is provided for in the law.

Senator PROXMIRE. What are the circumstances?

Mr. SIMONS. Where the project would have special problems, supposedly community oriented, and community orientation was very necessary for the success of that project, we could negotiate with a local manager who had some relationship with the community or the tenants.

I think that in trying to understand what we are trying to accomplish, it is very important to understand that the elements of tenant participation and community participation are almost essential in order to have success with low-income housing.

We are trying to bring these elements in on a basis of close monitoring with sound guidelines, through management representing these interests. The Department's view is that those people can be successful managers. Our responsibility is one of setting up the guidelines for monitoring the procedures which will give them the guidance and proper direction.

Senator PROXMIRE. Of course, the tenants testified less than 1 month ago, on November 13, that they had absolutely no opportunity to participate; none. They were seeking to participate, but there was uniform testimony from all of them as they appeared before us, and we had a number of them, that they were denied participation.

I went out there and talked with a number of tenants, as staff did also, on separate occasions, and we found no opportunity for them to participate. Their testimony was given, as I say, less than a month ago, on November 13.

Mr. SIMONS. My information is that we have worked with the tenants in Clifton Terrace. I understand that the tenants in Clifton Terrace have had concerns about the management and differences of opinion with the Department. To my knowledge, they will continue to be conferred with and decisions will be made with respect to management that are in the best interests of both the tenants and the Federal Government.

### PRIDE'S INSENSITIVITY AND TENANT DISSATISFACTION

Senator PROXMIRE. Apparently both Mr. Staller and Mr. Cameron, in separate memos, expressed their belief that despite P.I.'s financial problems, the firm had brought social sensitivity to management at Clifton Terrace, had been working with the residents at Clifton Terrace, and had been successful in resolving many of the problems of the project. Judging from the testimony of the Clifton Terrace Tenants Association on November 13, the tenants represented appear to take issue with these assessments of P.I.'s social sensitivity to the tenants. Mr. Blackwell, who has lived at Clifton Terrace for nearly 16 years said, "There was no communication between the tenants and P.I. at any time whatsoever the whole time they were there." Mr. Jacquet, another long-time resident of Clifton Terrace testified that P.I. Properties did away with the senior citizen program and made it difficult for senior citizens to gather in project meeting rooms.

In October of 1974, the tenants held a press conference at the project to protest that P.I. was a bad manager that maintained dirty and unlocked buildings and to accuse P.I. of "a lack of sensitivity in tenant management relations." That is a quotation from the Washington Star of October 30, 1974.

In the face of tenant dissatisfaction with P.I. Properties, what was the basis for Mr. Staller's and Mr. Cameron's statements that P.I. was socially sensitive and successful in resolving many of the problems of the project?

Mr. SIMONS. I have no idea.

Senator PROXMIRE. Mr. Cameron?

Mr. CAMERON. Mr. Chairman, let me first of all say the first indication that I would be here this morning was yesterday. Second, I would like to advise you regarding the details of the type——

Senator PROXMIRE. Let me just interrupt to say that we told the Department 2 weeks ago we wanted you here.

Mr. CAMERON. I became aware of it yesterday, sir. I have not been involved in any of the preparations for this hearing. However, with respect to your question, I can only give you a general answer.

The administration and operation of Clifton Terrace was in the hands of the area office. We were dependent on Mr. Staller, who was the director at that time, to advise us as to what was happening.

### GENERAL COUNSEL'S ADVICE

Senator PROXMIRE. Is Mr. Staller here? Apparently not.

Now, Mr. Cameron, in May of 1974 it was determined by HUD that Pride International was not, in fact, a nonprofit firm and thus did not qualify as a purchaser of Clifton Terrace. Apparently, Pride's head, Ms. Treadwell, responded by saying that she could organize a nonprofit corporation in a matter of days. HUD's General Counsel, Robert Elliott, then wrote H. R. Crawford on May 13, 1974, that he thought the nonprofit sponsor could not be deemed to be a suitable purchaser. Nevertheless, 3 days later the papers of P.I. Properties, a new nonprofit corporation, were submitted to HUD and on the same day the draft of an agreement to sell Clifton Terrace to the new corporation for $1.2 million was signed. Why did HUD ignore the advice of its General Counsel?

Mr. CAMERON. I am not sure Mr. Crawford did ignore the advice of General Counsel. As a matter of fact, the whole contract and everything dealing with the Clifton Terrace contract for sale was with the advice of the General Counsel. He sought that at every move, and every turn, and a determination which he made relative to that was worked over and was put together by the members of my staff and the General Counsel.

Senator PROXMIRE. That is hard to understand, because on May 13, as I said, HUD's General Counsel, Robert Elliott, wrote Mr. Crawford that he felt the nonprofit sponsor could not be deemed to be a suitable purchaser.

Mr. CAMERON. Because of their not being nonprofit.

Senator PROXMIRE. Three days later they went ahead.

Mr. CAMERON. They established——

Senator PROXMIRE. But Mr. Elliott said the nonprofit sponsor could not be deemed to be a suitable purchaser.

Mr. CAMERON. I am not familiar with the documents you are reading from, Senator, so I really cannot respond to your question.

### TRIAL PERIOD EXPENDITURES

Senator PROXMIRE. Mr. Simons, the terms of the sale agreement with P.I. Properties stated that P.I. would have a 6-month trial period in which the firm would be expected to manage the project, meet its bills, and make monthly payments to HUD out of rental income. According to the Washington Post, on August 2, 1974, a HUD senior accountant, John Mastradone, told P.I. that its June report, the first full month of the trial period did not contain invoices to back up expenditures totaling over $13,300.

Do you know—and I realize this was long before you were in HUD—but do you know, or do you have anybody in the room who can tell us, whether HUD ever required P.I. to produce these missing invoices?

Mr. SIMONS. In that specific instance, I don't think there is anybody in this room who can answer that. It would be handled by the loan servicer who was dealing with the project at the time at the area office level.

Senator PROXMIRE. Is Mr. Long here?

Would you come forward, sir.

Are you Kenneth Long?

Mr. LONG. Yes.

### DISBURSEMENTS

Senator PROXMIRE. According to the Washington Post article of October 23, as director of HUD's housing management activities in the

District of Columbia area office on February 6, 1975, you sent P.I. Properties a detailed breakdown of disbursements which P.I. had claimed and which HUD said raised a question of authorization. These totaled $18,426. This followed your directive that no invoices in excess of $200 could be paid by P.I. without prior HUD approval.

Ms. Treadwell said, according to the article, that this amount represented an accumulation of goods and services each costing $200 or less and thus did not require any HUD authorization.

Did your people look behind that statement and review the invoices for these claims to see if this was, in fact, the case and if not, why not?

Mr. LONG. I don't remember.

Senator PROXMIRE. Do you remember anything about that transaction?

Mr. LONG. I remember that dealing with Ms. Treadwell was very difficult and she worked the regulations and staff to their fullest to try to get the best that she could for herself. I remember just negotiating with her as being a very difficult thing.

Senator PROXMIRE. This seems to be an exceptional situation. We are dealing here with $18,426 in disbursements and a directive that no invoice in excess of $200 can be paid without prior HUD approval. Apparently it was claimed that there were a number of items of less than $200——

Mr. LONG. I can't hear you.

Senator PROXMIRE. There were $18,426 in disbursements. Obviously these were far, far, far in excess of the $200 limit. For Ms. Treadwell to claim that this was simply an accumulation of charges of less than $200 seems to me to be quite startling and unusual when the total amount is so great. We are not talking about $200 or $400 or $500 or less than $1,000, but $18,426.

Mr. LONG. Yes; but I don't recall.

Senator PROXMIRE. You don't recall that situation at all?

Mr. LONG. No; I don't.

Senator PROXMIRE. Wouldn't it be unusual to have that enormous a bill paid under those circumstances without HUD approval on the ground that the bill consisted of smaller items?

Mr. LONG. Yes, Senator, you are probably right, but you are asking me to recall something that may have taken place 4 years ago. I have to, in all honesty, say I don't recall.

Secretary LANDRIEU. Mr. Chairman.

Senator PROXMIRE. Yes.

Secretary LANDRIEU. I know the Senator certainly doesn't want to be unfair in this process, but as we pointed out in our testimony, HUD at that time was managing over 2,000 projects which were in default, and I daresay that with respect to every project, knowing the number of transactions that take place, when you begin to multiply that out you are going to be into hundreds of thousands of transactions. I think for the most part if the Chair wishes to submit those questions to us, we can go back to the Department and try to find out to your satisfaction what within HUD broke down so that if, in fact, something did or did not happen, we can respond to that particular question.

I think the individuals in HUD trying to recollect on the spur of the moment 4 years ago a particular transaction is most difficult. I am not here to justify every action of every individual within the Department. I am here to present the Department side and respond to questions which you have. But we find it very difficult, apparently, to respond.

Senator PROXMIRE. Let me just say, Mr. Secretary, that it is not as if we just picked 1 project out of 2,000 and said, "What were you doing on a certain day in 1974 and why didn't you act differently?" This is a project that was the subject of a series of articles in the Post. It has been a front-page story. It has been, I am sure, of the greatest concern to HUD for many, many days and weeks. It is a project you knew we were going to inquire into in considerable detail. I think it is quite different than if we selected at random 1 out of 2,000 projects and asked you about that. This is certainly the most conspicuous and perhaps one of the most troubled projects that you have. I do appreciate that it is hard for you to answer these detailed questions, but it seems to me it is necessary for me to ask them for the record and I would hope to the extent they can't be answered you would, as you suggest here——

Secretary LANDRIEU. I will certainly try to do my best.

Senator PROXMIRE. But I would hope you would be able to respond orally to some of these questions, because as I say they have been discussed in the paper and I am sure discussed to some extent by HUD.

### RECORDS IN POSSESSION OF U.S. ATTORNEY

Mr. SIMONS. Mr. Chairman, I would like to point out that basically all the records you are describing have been handed over to the U.S. attorney. The Department is not in control of them, so it will be even more difficult to answer some of these questions.

Senator PROXMIRE. I realize the U.S. attorney has them. As you know, we have been very scrupulous and careful in not asking any questions that would affect the actions of the U.S. attorney, but we had hoped you would follow the usual policy of xeroxing when they took over so you would have some records.

Let me proceed, and I will proceed as rapidly as I can.

Mr. SIMONS. We tried to save some money this time.

### PRIDE'S PERFORMANCE DURING TRIAL PERIOD

Senator PROXMIRE. Well, I am all for that.

By mid-April of 1975, P.I. had run up $93,566 in unpaid utility bills at Clifton Terrace in HUD's name.

Furthermore, according to the brief filed by the Justice Department in defense of foreclosure, during the 6-month trial period prior to the sale of the Clifton Terrace property, rent delinquencies increased from 6 percent to 52.2 percent under P.I.'s management.

Finally, a memo written by HUD's General Counsel prior to the sale stated: "To my knowledge, P.I. has not remitted $1 to the Department during the 9 months or so it has managed the property for the Department."

In view of this abysmal performance, why was P.I. allowed to purchase the property?

I am going to ask Mr. Cameron to answer the question, because, Mr. Cameron, I think you have been at HUD longer than anybody at the table.

Mr. CAMERON. Let me say, again, Senator, this was a decision of Mr. Crawford. In discussing this particular point with the Washington Post reporter, he asked me why I sent to Mr. Crawford two alternative approaches that he could take. At that time, I responded to him that I did not recall and really didn't want to comment at that point in time because I didn't recall precisely whether or not Mr. Crawford had asked me to do it this way or whether I did it as a normal way of handling a difficult problem. But be that as it may, we did present to the Assistant Secretary our view, along with another view which reflected what he thought he would like to proceed to do. And he had that choice and he made that selection, and that was his responsibility, not mine.

Senator PROXMIRE. Was it your view and did you make that view clear, that the property should not be sold to P.I., Inc.?

Mr. CAMERON. I made my view clear to Mr. Crawford orally that I felt that at this point in time he should not sell; yes.

Senator PROXMIRE. Are there any controls within the Department so that when you have that kind of a difference of opinion, and a staff recommendation is overridden, that decision to override can be made public, or at least be made a part of the record and documented?

Mr. CAMERON. I think what we are talking about is a judgmental question. It was a decision which he had to make. As far as I am concerned, personally, I think what he was trying to accomplish with Clifton as a demonstration project, generally, certainly was a good approach. We were acquiring properties of a difficult nature.

Senator PROXMIRE. Let me ask Mr. Simons a question on this same subject.

Mr. Simons, could this kind of thing happen today? You were very emphatic in pointing out, at least in connection with some matters here, that there was no contrary recommendation by the staff people who were directly in charge and had the most direct responsibility. Could this kind of thing we are talking about here occur now or do you have——

Mr. SIMONS. To answer the question which you presented to Mr. Cameron, any office director, anyone, is free to make a recommendation. I may have recommendations I do not agree with and may decide in my authority and judgment to override them. Those recommendations are made in writing and I have the responsibility to make a decision based upon the facts and recommendations placed before me. So there are many, many things in the file——

Senator PROXMIRE. I understand that. If you did override a recommendation—and I think obviously as an executive you have to override often—would you feel it necessary to specify in writing why and preserve the record?

Mr. SIMONS. As a matter of course, I would make a record as to why I override it on the basis of my judgment.

## WRITTEN JUSTIFICATION TO OVERRIDE RECOMMENDATIONS

Senator PROXMIRE. Is that Department policy at the present time?

Mr. SIMONS. It is the Department policy to create that administrative record.

Senator PROXMIRE. Even if, as in this case, the different opinion was expressed orally, not in writing?

Mr. SIMONS. I would question the validity of an oral recommendation. The choice of expressing an opinion orally or in writing is with the person expressing it.

Senator PROXMIRE. That is right. What I want to get at is, if a subordinate makes a recommendation orally with which you disagree and you override it, would you feel it is Department policy for you, in a matter of this importance, to reduce to writing your contrary decision?

Mr. SIMONS. The basis of my decision would be reduced to writing in any event.

Senator PROXMIRE. Do you want to comment, Mr. Secretary?

Secretary LANDRIEU. Yes, I do.

Mr. Chairman, I am not familiar with this particular procedure, but it would not be my feeling that in this Department where oral discussions take place and recommendations, suggestions are made, that there is a procedure by which all of that is reduced to writing. I believe that in the process of functioning in the Government, there has to be a certain latitude for staff discussion, recommendations, however you want to describe it, the communication between subordinate and superior, and ultimately a decision reached at the appropriate level.

I don't know of a particular process by which that is reduced formally to writing. Ultimately the decision, whether made by a subordinate in the first case or ultimately by the Assistant Secretary or by the Secretary, becomes the responsibility of the person heading the agency. I wasn't there at the time, but I would construe that to have been my responsibility as Secretary of that Department. I don't believe that responsibility can be shifted.

Now, to the extent we delegate authority to make those decisions, then that is the entitlement, of course, of the Secretary.

Senator PROXMIRE. It was stated in the Department's prepared testimony earlier, and I think Secretary Simons was absolutely correct to emphasize the fact that these decisions, in many instances, were made without any protest on the part of the people down the line, who have the day-to-day, detailed knowledge of the situation.

Here was a very, very important decision involving almost $1 million and it was a decision with which Mr. Cameron disagreed. It would seem under those circumstances it would be orderly and useful if a record was made of that disagreement. If you are going to take the position that the head of the Department has the ultimate responsibility and makes whatever decision he wishes to make and can disagree with his subordinates without any record, that is understandable, but then it is hard for us to accept the notion that Mr. Simons has put forth that the decisionmakers, in some of these circumstances, were never contradicted by people down the line.

How do we know? How does Mr. Simons know?

Mr. Simons. Mr. Chairman, if I could interject, in my prepared testimony, in dealing with this decision, I pointed out that the Congress itself, the House Appropriations Committee, checked into the question of why that transaction was approved, and Assistant Secretary Crawford stated for the record at that time why he went ahead with that transaction.

Senator Proxmire. Is Mr. Clay here?

Mr. Clay. Yes.

### PRIDE'S SOCIALLY ORIENTED ACTIVITIES

Senator Proxmire. Sir, the memorandum from you to Assistant Secretary Simons, dated December 1977, in discussing the original sale to P.I., states that:

> The buyer was also required to commit to undertaking certain socially oriented activities, which are questionable at best, considering the drain on financial resources. The buyer agreed to these terms in consideration of obtaining the project for an unbelievably low price.

What were these socially oriented activities which resulted in the project being sold to P.I., Inc., for, in your words, "an unbelievably low price"?

Mr. Clay. As I recall, there was a requirement that the owners plan and offer social services and activities for the elderly and for the children and I think the owners also interpreted that to mean that they were allowed to make what we considered unusual expenditures on items and on activities that are not normally allowed. That is what that reference was to.

Senator Proxmire. I understand they never did provide those services and make those expenditures.

Mr. Clay. There were expenditures tnat they reported to us that they had made for Christmas parties, Thanksgiving baskets, flowers, and things like that. The issue was when we anticipated——

Senator Proxmire. That amounted to, I think, $3,000 in expenditures. Is that what made it worth selling the project to them for an unbelievably low price——

Mr. Clay. I am sorry. I don't understand what you are saying. You have lost me. I am sorry.

Senator Proxmire. My question is, Did the $3,000 or $4,000 in Christmas gifts, which is all that we know about regarding socially oriented activity, justify the sale of this property at hundreds of thousands of dollars below the original price, at what you call an unbelievably low price?

Mr. Clay. If I understand your question, the answer to the question is "No," but that was not the only requirement that was laid on the project in terms of offering that activity.

Senator Proxmire. What were the activities that made it worthwhile to sell this project for an unbelievably low price?

Mr. Clay. I think what my statement said, as I remember writing it was—you confuse me, I am sorry—I don't think it was worth that. That was the issue, but I think it ought to be clear that from the point of view of the owner, those requirements, whether it was $3,000 or

$30,000. I am not sure, but there were also other requirements laid on, requirements to maintain some units at below-market value, which they considered was a compensation on their part in order to justify the price that was finally arrived at.

Senator PROXMIRE. But in your judgment——

Mr. CLAY. That was my judgment; yes.

Senator PROXMIRE. And, in your judgment, the price was too low; is that right?

Mr. CLAY. That was my opinion; yes.

### WRITEDOWN OF PRICE TO ACHIEVE AFFORDABILITY

Secretary LANDRIEU. Mr. Chairman, I won't take issue with that and I guess in looking at problems which currently face this Department, we are now discussing sales prices on properties which we have.

Let me give you an example. There are some instances in which, if we permit a project to be turned over for condominium sale, we could probably maximize the Federal dollar. In so doing, we would take heretofore rental units off the market and we also have a certain displacement of the tenants who are there. Those are policy matters with which we have to wrestle. You measure selling this property on the open market with competitive bidding against our social responsibility to keep it in the rental market and, at a cost to the tenant that permits low- and moderate-income people to use it. In this instance, I think what Assistant Secretary Simons testified to was that in structuring the transfer, that if the price were any higher than what it was, then the revenue projections off the project could not service the debt and maintain that project as a viable project.

What good does it do if you are trying to keep a project available for the low- or moderate-income persons, to sell it at what might be construed to be market value if in fact the rent you can charge the tenants cannot possibly service that debt? You automatically build in a disaster.

### OWNER'S LACK OF FINANCIAL STAKE

Senator PROXMIRE. I understand that. You make a very good point, and I am not going to dispute it. I was just asking what social services made it worth selling Clifton Terrace at an unbelievably low price. I realize there were other reasons you sold it at an unbelievably low price. The phrase "unbelievably low price" was not mine, but Mr. Clay's.

HUD gave P.I. Properties a 100-percent mortgage on Clifton Terrace. No cash payment was involved, as I understand it.

Mr. Simons, didn't this 100-percent mortgage mean that the owners of Clifton Terrace had very little financial stake in the project and could walk away from it with very little loss?

Mr. SIMONS. There are many programs in which the owner has no financial stakes. Here, there was no financial stake in the sense of investment in the ownership.

Senator PROXMIRE. Is it common for HUD to use 100-percent mortgages in disposing of properties in the HUD inventory?

Mr. SIMONS. It is not common, Senator. However, it depends on the nature of the transaction. We are moving to standardize our property disposition policies. It is one option that is looked at if there is a benefit to flow from that. Basically, however, that is not the policy.

Senator PROXMIRE. A 100-percent mortgage, as I understand it, requires no financial investment on the part of the so-called owner; is that right?

### REASONS FOR 100-PERCENT MORTGAGES

Mr. SIMONS. Senator, the basic issues come down to management. When you are dealing with low-income projects that do not have a cash flow to provide any return, the real issue at that point is management. What we are seeking and what our policies seek to do in those instances is to optimize the type of management we can bring in. It may require nonprofit groups, community-based groups, tenant groups trying to promote cooperative sales, and other types of transactions.

Senator PROXMIRE. That is very appealing if you have really top-flight management.

Mr. SIMONS. By the way, to require a financial investment I think, impinges upon HUD's ability to get the optimum type of management.

Senator PROXMIRE. You certainly didn't get the optimum type of management you needed here.

Mr. SIMONS. Absolutely; I agree with you.

Senator PROXMIRE. You got very bad management for your 100-percent mortgage.

Mr. SIMONS. I don't think they equate themselves. The equation no investment equals bad management is unfair to the thousands——

Senator PROXMIRE. The purpose of the 100-percent mortgage, as you just explained it to me, is to get really good management, which may not have the financial wherewithal to make a downpayment.

In this case, you didn't get it.

Mr. SIMONS. Senator Proxmire, I would say I agree with you.

Senator PROXMIRE. Senator Bellmon?

Senator BELLMON. Mr. Chairman, on page 2 of Secretary Simons' statement, he points out——

Senator PROXMIRE. Do you refer to his summary statement?

Senator BELLMON. His summary statement; right. He points out several things Department personnel expected to do, which they never did. I haven't been in here the whole period. Has this matter been explored?

Senator PROXMIRE. No; that has not.

### ASSURING EXERCISE OF RESPONSIBILITY BY OFFICIALS

Senator BELLMON. You say, Mr. Simons, "They had the duty and authority to recommend foreclosure and to set forth any findings of fraud at the project, in writing, which they never did. They had the duty, the authority, and the responsibility under HUD regulations to pursue their concerns independently with the Inspector General, if they thought their concerns were being ignored, which they never did. They had the duty, and the authority to demand a more thorough audit, which they never did."

As a result of what evolved in the Clifton Terrace matter, what has been done to make certain these officials who have this responsibility take the actions that they failed to take in this case in future cases of this kind?

Mr. SIMONS. To answer that question, Senator, I think we must put in context the many changes in policies we have implemented with respect to dealing with troubled projects.

Senator BELLMON. Have you made those changes in policies a part of the record?

Mr. SIMONS. They are part of the record. In fact, we will provide a detailed statement of all the policies that are being implemented. As the policies are put in place with proper objectives clearly defined, guidance to and responsibilities of those employees in HUD who have a day-to-day responsibility for dealing with these areas will be more clearly defined, and their performance can be more easily reviewed and evaluated.

### INSURANCE OF FULL MORTGAGE AMOUNT

Senator BELLMON. I believe you have also gone into this matter slightly, but let me raise it again. It is my understanding that FHA currently guarantees a 100-percent bailout on its section 8 new construction loans. At the same time, the VA provides only 20 percent for private industry.

Does this practice encourage putting the burden of the cost of failing projects on the Federal Government rather than on the mortgagee or the limited partnership members? What I can't understand is why it is necessary for the FHA to provide a 100-percent bailout when the VA provides only 20 percent, yet the VA seems to get a lot of building done also.

Mr. SIMONS. Senator, I really don't understand the question. Under FHA insurance, we provide 100-percent insurance for mortgages. That is mandated by law; the FHA insures 100 percent. If there is an assignment at that point, we are mandated by law, again, to pay that amount.

Senator BELLMON. My question is, Why does HUD need such a fat guarantee when the VA provides only 20 percent and seems to get a great deal of comfort?

Mr. SIMONS. I am not familiar with which VA provision you are talking about. If it is 20 percent of the guarantee on a multifamily project, I don't know if that is the law or not.

Senator BELLMON. I am not aware——

Mr. SIMONS. Now, VA is a guaranteed program up to a certain amount. We are an insuring program. There is a difference.

Senator BELLMON. My question is, Do you need 100 percent insurance?

Mr. SIMONS. I think in order to assure the proper flow of funds in housing, we need 100-percent insurance. The VA, which does not have 100-percent insurance now, sells its mortgages to Ginnie Mae—GNMA—which provides a full Government guarantee for the mortgage. So, in essence, the Government guarantees the full amount, although not through the VA law.

By putting the mortgages into mortgage-backed securities, you pick up the Ginnie Mae guarantee, which gives them the full 100 percent.

Senator BELLMON. Suppose Congress was to rewrite the law and reduce the FHA guarantee down to 80 percent. What would be the effect of such an action?

Mr. SIMONS. It would have an inhibiting effect on the flow of mortgage credit. Basically, the FHA insurance is designed to insure mortgage credit at the least possibie expense to the purchaser.

Senator BELLMON. Wouldn't it also have the effect of making sponsors of these projects more careful in their management?

Mr. SIMONS. Now we are going from single-family to multifamily projects; we do require equity investment on the part of profit-motivated sponsors. There is a requirement; yes.

Senator BELLMON. On multifamily projects, suppose we reduce the 100-percent guarantee down to 80 percent. What would be the effect of that?

Mr. SIMONS. The effect of that would most likely be diminished participation in the program. We feel the purposes of the program are accomplished by the 10-percent investment which is required. Increasing that investment will have an inhibiting effect on the participants.

### EQUITY REQUIREMENTS FOR PURCHASE

Senator BELLMON. As I understand it, HUD currently requires that mortgage companies have an equity base of $100,000 which can be in the form of a home, office building, or land, on which the project will eventually be built. To me this seems like an extremely low requirement and would encourage mortgage companies to get in the business of federally subsidized housing. Is there some reason for keeping this so low? It looks to me like you are inviting these kinds of disasters.

Mr. SIMONS. There is no fixed amount required for participating in the program. As you process a multifamily project the developer must evidence the availability of funds amounting to the difference between the mortgage amount and the amount necessary for the total development to insure that the project can be completed.

In addition to that, the developer's experience in the program and his previous participation with the Department are evaluated. But, from the financial standpoint, when you go through the underwriting process on a multifamily project, that money needed above the mortgage must be present for the job and satisfactory evidence of this must be presented before the initial closing takes place.

Senator BELLMON. If you are making 100-percent mortgage, there isn't any money needed above the mortgage.

Mr. SIMONS. We are not making 100-percent mortgages in multifamily projects; we are making 90 percent, sometimes less. Many times the loan is only 82 or 80 percent.

Senator BELLMON. Let me give you a scenario I am convinced happens. A developer will buy attractive land, perhaps undeveloped land, at a fairly low price and then reappraise it in connection with one of these projects at a much higher price, which HUD will agree to, and use that then as the equity for the project.

Mr. SIMONS. The procedures for the appraisal of the land, Senator, are supposed to be done based upon the cost of the land provided——

Senator BELLMON. The cost of the land?

Mr. SIMONS. Right; assuming that the land was not bought a long time before. If somebody has owned the land for 20 years, the incremental value must be taken into consideration. Basically, our procedures require us to use the actual cost if it has been purchased recently.

Senator BELLMON. So then you are saying it is not possible for a developer to go out and buy a patch of farmland for a thousand dollars an acre and immediately put a $10,000 price on it?

Mr. SIMONS. It is not possible.

Senator BELLMON. Are you saying it has never happened?

Mr. SIMONS. Our procedures do not permit this. I am not saying it doesn't happen. I have 20,000 multifamily projects that are processed out there that we are responsible for. We hope that this is not the case, the guidelines and directions are not the——

Senator BELLMON. How do you go about determining what the developer actually paid for land?

Mr. SIMONS. He must present evidence of that. Usually there is very easy evidence.

Senator BELLMON. In our State, there is no requirement that the purchaser has to make a public disclosure——

Mr. SIMONS. In our programs, the developer must make a certification as to what he paid for that land. The price allowed is based upon that certification, and whatever additional evidence he presents in support. In many instances we must act on a person's certification.

Senator BELLMON. Does HUD make any effort to go behind what the developer certifies to ascertain whether the certification is accurate?

Mr. SIMONS. No; we do not. The check on that would be what we perceive to be the fair market value. There is a second check done through the appraiser's idea of what the fair market value should be.

Senator BELLMON. So HUD doesn't then make an effort to put its own value on the property?

Mr. SIMONS. No. But that is the cap; that is the limiting factor.

### DEFAULTED AND HUD-HELD MORTGAGES

Senator BELLMON. How many other multifamily projects which are failing have not been foreclosed on?

Mr. SIMONS. We have, of the projects with mortgages held by HUD, 460 that have not been foreclosed on that have a potential for foreclosure and they are now under a workout agreement today. We have over 2,000 projects with HUD-held mortgages: 788 of them are current under the original mortgage terms; 263 are current under workout terms; 134 are in default under workout terms; 381 are in foreclosure; and the balance, 460, are not in foreclosure or under workout.

Senator BELLMON. Mr. Chairman, that is all I have.

Senator PROXMIRE. Thank you, Senator Bellmon. Incidentally, the subcommittee will take a look at the overall picture, as you know, in January, when we will be examining the HUD-managed inventory in detail.

### 1977 AUDIT OF CLIFTON TERRACE

Mr. Dempsey, the Inspector General, plays a very critical part in alerting the Secretary to any prospect of fraud or corruption. If you fall down in your audits in any way, it makes it extremely difficult for the head of the agency to be on top of problems, especially in an area as complicated and diverse as housing and urban development.

From all the information that has become available thus far, it would seem the May 17, 1977, audit of P.I. Properties, Inc., by HUD's Office of Inspector General was completely inadequate. Can you tell us how many auditors performed the audit and how much time they devoted to it?

Mr. DEMPSEY. Yes; two auditors, a grade 11 and grade 12, were assigned. The auditing was completed in approximately 80 workdays. There was also a supervisory auditor who was periodically working with them. However, he was also working on another special project at that time. All of the assigned audit staff reported to the regional inspector general in Philadelphia.

Mr. DEMPSEY. It was 60 calendar days, Senator, approximately 80 workdays.

Senator PROXMIRE. In the summary of your May 27 audit, it is stated:

> We determined that the books and records were incomplete, inaccurate, and, in some instances, could not be located. Therefore, we concluded that a comprehensive audit could not be performed until deficiencies in the financial records were corrected.

When GAO came before us last month they discussed the adequacy of your audit given the material you had at hand. GAO felt, and I am quoting here from their testimony, that:

> Knowing the background of the project, knowing the difficulties that have gone before, one would have made a detailed audit. There are some instances where, perhaps, things appear clean and you don't have to go into such detail. But here was a situation where a project has had problems before it was even purchased by P.I., Inc., and I think auditors would have been on notice that this requires a detailed audit.

I recognize that books and records were missing, but given the past problems of the mortgagor, shouldn't the auditors have gone over the records that were available, the monthly reports and so forth, very carefully?

Mr. DEMPSEY. Sir, this audit was not designed or intended to be a full or detailed audit. It could not be an in-depth audit because of the incomplete, inaccurate, and unavailable records. In hindsight, 3 years after the fact, in looking at what the auditors did on the available records, I feel, as GAO felt, that perhaps they should have detected these items; yes.

### UNDETECTED IRREGULARITIES IN MONTHLY REPORTS

Senator PROXMIRE. Discrepancies appeared on monthly disbursement sheets P.I. filed with HUD that should have indicated an investigation of the project was warranted. In fact, these discrepancies must have gone unnoticed because they were not mentioned in the audit report.

For example, the July 1976 monthly report to HUD by P.I. listed a $3,160 charge for "management fee—July." But in the August report another $3,039.90 was charged for "July management fee."

GAO testified last month before the subcommittee that this double payment should have been questioned by both the HUD area office people responsible for receiving and looking at these reports, and the auditors who later examined the transactions.

Why wasn't this double payment detected and mentioned in the audit report?

Mr. DEMPSEY. I believe, sir, in this instance, the auditor should have been on the alert for such a transaction, and I cannot say why it was not found. It is possible it can be detected through a scanning of the material, but it was not detected.

Senator PROXMIRE. The November 1976 Clifton Terrace accounting shows a $3,000 loan to Pride Environmental Services. Isn't the charging of such a loan against project income at a time when monthly mortgage payment obligations cannot be met a violation of HUD regulations?

Mr. DEMPSEY. Yes, sir; there is a prohibition against the distribution of income in this manner.

Senator PROXMIRE. Why wasn't this improper transaction picked up by your auditors?

Mr. DEMPSEY. The auditors should have picked it up. I agree with GAO.

Senator PROXMIRE. The December 1976 disbursement sheet indicates that P.I. used $6,700 to repay loans. These payments should not have been made until P.I, made good on delinquent mortgage payments. Other loan repayments were made: $2,000 in January, $4,976 in February, and $1,500 in March of 1977.

Aren't such loan repayments in violation of HUD regulations if they take precedence over mortgage payments and isn't this, in fact, one way in which project income can be improperly diverted?

Mr. DEMPSEY. It could; yes.

Senator PROXMIRE. Was it true in this case?

Mr. DEMPSEY. I can't answer that right now, sir.

Senator PROXMIRE. Certainly it violates HUD regulations.

Mr. DEMPSEY. Right.

Senator PROXMIRE. Why weren't those loan repayments detected by your auditors and mentioned in the May 27 report?

Mr. DEMPSEY. I think, in this particular instance, their review stopped with December. You are now talking about January, February, and March. Had they reviewed January, February, and March they should have caught it.

Senator PROXMIRE. An examination of monthly reports on Clifton Terrace shows great fluctuations in laundry income. For example, the March 1977 report shows $1,278 in income for a 2-month period. The May 1977 report shows only $40.88 in laundry income. The July 1976 report shows $806 in laundry income, yet there is no laundry income reported for the following 3 months. Why wasn't this irregular income pattern picked up by your 1977 HUD audit?

Mr. DEMPSEY. My understanding, again 3 years after the fact, is that it was not reviewed by the auditors, although perhaps it should have been. It was not reviewed by them.

Senator PROXMIRE. It should have been, certainly——

Mr. DEMPSEY. Yes, sir.

Senator PROXMIRE [continuing]. In view of the irregularity of that income.

Mr. DEMPSEY. It should have been.

## INSPECTOR GENERAL AUDIT AND KNOWN IRREGULARITIES

Senator PROXMIRE. In a memorandum accompanying its May 27, 1977, Clifton Terrace audit, HUD's Office of Audit stated that the area office—

> has been delinquent in its responsibilities and needs to improve its servicing of the project.

The memo went on to say:

> During our interviews with the area office housing management personnel, prior to commencing the project audit, your staff pointed out many irregularities involving project costs as shown on the monthly disbursement statements.

The memo also stated that the monthly financial reports—

> Indicated potential problem areas which should have been investigated and resolved by the area office on a timely basis.

Why weren't those irregularities investigated by either the Office of Inspector General or by the area office?

Mr. DEMPSEY. I can't answer for the area office. I feel it should have been checked by the area office. It was brought to their attention.

Again, after being on site, one of the auditors said the accounts were a complete mess—his words. I feel, looking back after 3 years, that they were very frustrated at that point. They had run into opposition, an uncooperative attitude on the part of the Pride people. They couldn't find records, they were promised records one day, went back the next day, and they weren't there. It was frustration. I think this is the reason the regional inspector general in Philadelphia finally said, "Enough's enough; stop right there. Pull out and ask for a CPA to come in and put the records together."

Senator PROXMIRE. It seems to me that when you encounter that kind of uncooperative hostile attitude, that is the time to blow the whistle. If anyone is going to be listened to when there is a possibility of corruption and incompetence, it's you. That is your job.

Mr. DEMPSEY. Whenever there is an indication of incompetence or corruption, certainly we should blow the whistle, Senator. You must remember, sir, this was 1977, and this is by no means an excuse, but I would like to make a point.

The inspector general bill was signed by the President in October 1978 and it has been from that point on that strong measures have been taken to request and even push the audit community to look for, search, and detect fraud, waste, and abuse. In those areas, 3 years ago, the emphasis was not as strong as it is today.

Senator PROXMIRE. Let me ask Mr. Clay a question.

Mr. Clay, the memo accompanying the May 27 audit, as I said, indicated potential problem areas which should have been investigated and resolved by the area office on a timely basis. Why didn't the area office investigate?

Mr. CLAY. Senator, I think it depends on what you mean by "investigate." The area office staff was not capable of going to a project to perform an audit. So when you say "investigate," what do you mean?

Senator PROXMIRE. These are the Inspector General's words. What did you mean, Mr. Dempsey?

### AREA OFFICE FAILS TO RESOLVE PROBLEMS

Mr. Dempsey. I missed the point here. The area office has certain things that they are to do and I am not pointing a finger, but there are certain reviews of records, files, and procedures that they should perform in the normal course of their proceedings. We look to them and ask them to do it, and that is their responsibility.

Mr. Clay. I will respond to that. I think the reason, to get back to the point, that we wanted an official audit is because I requested the staff to review past financial statements. One of the things that I discovered is the financial statements that the project had been submitting were not the official financial statements that were required by the Department. What we had been getting for a period of months had been printouts that carried expenses not only of Clifton Terrace but two additional projects.

We then directed the owner to correct that situation and come in to us with corrected financial statements for those months. Once those statements were reviewed in-house by staff, sufficient questions were raised that we thought we needed a professional view from the auditors as to what the financial condition of that project was.

Senator Proxmire. So your position is, the auditors should have corrected the situation and the auditor's position is the area office should have corrected it.

Mr. Clay. I did not say that. I did not say the auditors should have corrected it. I was attempting to respond to your question as to what was the role of the staff and how we came to the point of requesting the auditors to go and give us findings. Once the findings were made it was clearly the responsibility of the office to take the action to make the corrections, not the responsibility of the auditors.

Senator Proxmire. The finding clearly stated that the monthly reports indicated potential problem areas which should have been investigated and resolved by the area office on a timely basis.

Mr. Clay. And we did not do that.

Senator Proxmire. Did you do it after the findings?

Mr. Clay. We attempted to; yes.

Senator Proxmire. Did you go back and look at the earlier findings?

Mr. Clay. We went back and looked at the complete record of the project. We looked at all the findings, we requested additional information, we requested updates and so forth. Yes, we attempted to do that.

### MISSING RECORDS AND THE SUSPICION OF FRAUD

Senator Proxmire. Mr. Dempsey, one of the two auditors performing the May 27, 1977, Clifton Terrace audit was quoted by the Washington Post as calling P.I.'s accounts, "By far the worst mess I'd ever seen."

HUD's Assistant Inspector General for Investigations, when asked by the Post whether the auditors' discovery of missing records aroused any suspicion, was reported to have responded, "It's very unusual to have missing records, but this in itself is not cause for an investigation."

Shouldn't the fact situation in the Clifton Terrace case have raised a suspicion of possible fraud?

Mr. Dempsey. Sir, with the information that I had available to me after we got back in January and what has resulted from that point on, I think the record speaks for itself. As concerns the statement on missing records, I think it was taken somewhat out of context and I'd like Mr. Adams to explain the circumstances and meaning of his statement.

He is the Assistant Inspector General.

Senator Proxmire. Is Mr. Adams here?

Mr. Adams. Yes.

Senator Proxmire. Mr. Adams, would you come forward?

We have a baseball team right now. You have nine members.

Mr. Adams. When asked the question concerning the missing records by the Washington Post, I responded the mere absence of records was not necessarily a cause for the initiation of an investigation. That was in a general sense and not specifically with regards to this project. In the absence of records, the management of the project should be given the opportunity to provide those records.

Senator Proxmire. You say your remarks weren't in response to this particular project?

Mr. Adams. Correct, sir.

Senator Proxmire. You weren't talking about Clifton Terrace when you said that?

Mr. Adams. Correct.

Senator Proxmire. In this situation, do you think you should have required an investigation?

Mr. Adams. Retrospectively, probably so, sir.

Mr. Dempsey. Mr. Chairman, the missing records and files were indicative of some serious problems, and I don't want to play on words. However, it is one thing to have missing records and it is another thing to have records that are missing. The records that are missing should have been searched for by the CPA, which we requested them to do, and then, if they cannot be found, then they are missing records and at that point someone ought to take a look at this.

Senator Proxmire. Mr. Simons, one of the great problems HUD seems to have faced in dealing with the Clifton Terrace case was the lack of a proper accounting and financial reporting system. A memorandum from Thomas R. Hobbs to Fred W. Pfaender dated April 19, 1978, states:

> Our assessment of the quality and effectiveness of the Clifton Terrace management has been hampered by lack of financial reporting. We were assured from about September of 1976 that the 1975 annual financial statement was being prepared and that the 1976 statement would be forthcoming in early 1977. We still do not have any annual financial statement for Clifton Terrace from P.I. Properties, although it is a requirement of the regulatory agreement, and it was a request in your letter of requirements to P.I. Properties.

I find it very difficult to understand why you didn't tell P.I. way back in September of 1976, when you first started to be concerned over the lack of financial reporting, that they had 2 or 4 or 6 weeks to sign a contract with a reputable auditor to audit the records and prepare a financial report by the end of the year and that if a contract was not signed within the prescribed time span you would consider that cause for foreclosure. Why did you go 2½ years without setting a deadline for such an audit and accounting?

Mr. SIMONS. I am trying to understand your question, Mr. Chairman. I think in September of 1976, the area office was concerned about the lack of financial records and I think that is what led to calling for the audit which was done in early 1977. I think, also, understanding the entire atmosphere in which Clifton Terrace was presented to the Department, the Department's objective was to create clear and definitive responsibilities on the part of the ownership of Clifton Terrace so that action could be taken.

Senator PROXMIRE. Let me interrupt. Why couldn't you require that the records be brought up to date?

Mr. SIMONS. We did.

Senator PROXMIRE. It was required by the regulatory agreement?

Mr. SIMONS. We did require that.

Senator PROXMIRE. When?

Mr. SIMONS. Right after the audit findings.

Senator PROXMIRE. What was that date?

Mr. SIMONS. That would have been in April or May of 1977.

Senator PROXMIRE. Did you give the owners a deadline by which the books had to be brought up to date?

Mr. SIMONS. I don't remember. The record will show it. There was a deadline.

Senator PROXMIRE. The books never were brought up to date.

Mr. SIMONS. They were never brought up to date and that was the basis for the foreclosure. I am told that one of the financial statements was submitted, but not all the financial statements required, and that was one of the bases for foreclosing.

Senator PROXMIRE. I don't understand why you didn't set a deadline when you first started being concerned over the lack of financial reporting.

Mr. SIMONS. The Department informed them, as I remember, that they expected within 90 days the contract would be signed and the audits would be initiated. Some of those certified financial statements were provided to the Department, but not all of them. One of the requirements for closing the audit findings was to have certified financial statements provided.

Senator PROXMIRE. Mr. Dempsey, on the surface, your May 27, 1977, audit seems to have been an extremely thorough one. Anyone who examined the audit report would be impressed by some of the detailed findings. For example, the report questions the use of project funds to pay for Christmas stockings at a cost of $323.40. This kind of finding leads one to believe that the auditors went over the monthly submissions with a fine tooth comb and even questioned marginal expenses. In fact, just the opposite appears to be the case. The auditors missed a duplicate payment, improper loan repayments, and sharp fluctuations in laundry income.

How could the auditors be so detailed in some of their findings and yet overlook obviously improper charges against project income?

Mr. DEMPSEY. I can't explain that, sir. I have been, in the past, critical of certain audits and felt at times they did nit-pick on things, too. I wish they had caught these other items. They did not, sir.

Senator PROXMIRE. Mr. Simons, I would like to ask you about documentation for project costs.

A memorandum to Regional Administrator Thomas C. Maloney from Thomas R. Hobbs dated March 29, 1978, recapped HUD's efforts to resolve the May 1977 audit findings. The memorandum cited the audit finding that documentation to support costs charged to the project was inadequate and went on to state, "In our field review we ascertained that proper documentation is now provided."

In retrospect, that observation seems, at the very least, rather naive. What was the basis for your finding that P.I. was now providing proper documentation for project costs?

Mr. SIMONS. I couldn't answer what the exact basis was. My assumption would be they were looking for the supporting documents to suppport the expenses of the projects and those supporting documents were made available to them at that point.

Senator PROXMIRE. Will you take a look at this question for the recpord and see if you can provide a more detailed answer?

Mr. Clay, when the Clifton Terrace tenants testified last month, I asked Mr. Blackwell about a memo HUD area office staffer Jack Gifford apparently wrote for the files on July 13, 1977, indicating he received a call from a Clifton Terrace resident saying that "P.I. Properties were hauling refrigerators, stoves, toilets, plumbing parts, and so forth, off the premises."

According to the memo, HUD's reaction was to call the P.I. project manager, who in turn referred to this as normal replacement activity.

Mr. Jacquet, a long-time resident at Clifton Terrace and a former security guard at the project, said that he saw the trucks sitting in the back of the building with frigidaires and stoves going away from the project, not coming to it.

Why wasn't this rather serious allegation independently investigated, especially in view of other problems at the project?

Mr. CLAY. I saw the same statement in the paper. I think, as the paper indicated, Mr. Gifford wrote a memo to the files. I do not recall having had that issue discussed with me or having been advised by any tenant, security guard, or any other person that such an incident took place.

Senator PROXMIRE. Was this just a breakdown in communication among the staff?

Mr. CLAY. I would assume, knowing Mr. Gifford's competence and responsibility, that if, indeed, he made a determination based on the telephone call that there was a serious problem or a suspected activity going on, that he would have reported that directly to me.

## DELAY PRIOR TO INITIATING FORECLOSURE

Senator PROXMIRE. Mr. Simons, by May 27, 1977, a number of key danger signals had been sent up the line by various HUD officials, warning of serious difficulties at Clifton Terrace. There was the September 1976 memo from Mr. Pfaender to Mr. Staller urging a prompt audit of the project and suggesting foreclosure may be the only alternative; an April 26, 1977, letter from Mr. Pfaender to you raising suspicions of misuse of project funds by P.I. and containing a recap of delinquent mortgage payments; and finally, a sharp criticism of the District of Columbia area office by Mr. Brown, the regional inspector general, regarding the area office's failure to pick up potential problems at the project by reviewing monthly financial reports from P.I. and to require annual financial statements from P.I. as required by the regulatory agreement. Then on June 20, 1977, Area Director Clay wrote to Mr. Pfaender, recommending foreclosure immediately.

In the face of this overwhelming case for foreclosure, why did it take until July of 1978—that is, more than a year after Mr. Clay's recommendation—to initiate foreclosure proceedings against P.I.?

Mr. SIMONS. Mr. Chairman, I think I have dealt with this in my testimony, but I will be glad to recap it. At the time that the information memos were sent to me concerning Clifton Terrace, the project was being processed by the area office manager and by the Director of the Office of Loan Management.

If foreclosure is recommended by the area office manager, it can be acted upon, a final decision on foreclosure can be made by the Director of the Office of Loan Management then. It was within their purview to deal with this project at that time. These memos were raised to me for information purposes. The issue before us at that time was, Is foreclosure a proper path? I think that is really the issue before this committee as we look at Clifton Terrace. The path of foreclosure is a very difficult one, fraught with many, many misgivings for the Department. The length of time of foreclosure is something we have no control over. We have court opinions with respect to foreclosure for assisted housing which puts an additional burden on the Department, more than just collecting mortgage payments, but also being sure that project is being serviced properly.

For that reason, the owners raising questions as to whether HUD had fulfilled its obligations at the time of the original transfer, whether HUD's failure to fulfill those obligations was impeding the owner in the management and the proper performance of its responsibilities under that agreement, were serious issues. If we moved to foreclose at that time and those issues were not dealt with properly, chances are the foreclosure proceeding would still be going on, the Department would have no control, and the ones who would suffer would be the tenants.

It is our experience in lengthy foreclosure proceedings the ones who suffer most are the tenants, because the project deteriorates.

Senator PROXMIRE. In this case the tenants were already suffering, at least that was their testimony, and my firsthand observation was that their suffering was continuing.

### NEED TO CREATE CLEAR ADMINISTRATIVE RECORD

Mr. SIMONS. I would say people suffer many times. I think they would have suffered more if this Department had been forced into protracted foreclosure proceedings at that time. It was the Department's feeling that if there was to be foreclosure consistent with the *Kent Farms* case, we had to build a sound administrative record.

To build that sound record, we had to build it around the performance of their management responsibilities. The area office tried to do that from July of 1977 to December of 1977 and found it could not do that and could not get cooperation from the owners.

When the case was returned to central office for guidance and handling, Deputy Assistant Secretary Melkonian proceeded with an approach in a way that we were able to get speedy foreclosure. The end result is, when we did institute foreclosure proceedings, we had built a proper administrative record to do it and the proceedings went rapidly.

The Department got possession of the project and what is more important, the Department was able to continue its processes and turn this case over to the U.S. attorney.

### NEED FOR EXPEDITIOUS FORECLOSURE PROCEEDINGS

Senator PROXMIRE. I think perhaps we will have to go into this next issue in considerably greater detail in January, because it is a general question.

From what you have told me today, it seems we should have more expeditious procedures for foreclosures when they are in order.

Mr. SIMONS. We fully agree with you, Mr. Chairman.

Senator PROXMIRE. It is the delay which is unfortunate.

Mr. Clay, you were the area office director in June of 1977. You initially recommended foreclosure. Hindsight has proven you to be correct. Why did you reverse that recommendation?

Mr. CLAY. Just a comment. You emphasized that the request was to foreclose immediately and writing any foreclosure recommendations, that is the language one uses in the Departmen.

Senator PROXMIRE. I was quoting your words.

Mr. CLAY. I think you asked me why did I reverse?

Senator PROXMIRE. Yes.

### WITHDRAWAL OF FORECLOSURE RECOMMENDATION

Mr. CLAY. The reversal was made based on reconsideration in conversations that I had with other officials in the Department after I had forwarded the initial recommendation. Within that recommendation—I think if you look at it closely—we tried to spell out, based on a very cursory kind of investigation on my part, since I had not been involved in the project that long, given the other problem cases we have in our Office, the other pressures I have in terms of programs, after looking at that project, I made a determination that that project could not operate based on how it had to currently be serviced.

My servicers were put in a position to service a project that really had been put in a category different from any other project in the Department that they were required to service.

Senator PROXMIRE. Your key phrase here is "in consultation with other officials."

Mr. CLAY. Yes.

Senator PROXMIRE. Who were the other officials?

Mr. CLAY. I had a conversation with the Regional Administrator, Tom Maloney, I think Assistant Secretary Simons, then Secretary Harris, and perhaps someone else. During the course of those conversations and discussions of the project, the question was raised to to whether or not I felt that I had and the Office had done everything that we could, that was reasonable, to make that project viable and to keep it operational. The response to that clearly had to be that I had not, because I think the record would show that my involvement in that project at that point had not been for a long period of time.

Senator PROXMIRE. Mr. Clay, you indicated in your December 1977 memorandum, that you were "not prepared at that time to provide the assurance" that all possible steps had been taken because, in your own words, "I had only recently become involved with the project." You continued, "I am now prepared after 7 months of personal involvement * * * to submit a recommendation." This statement would seem to imply an extraordinary foreclosure standard—a standard that would require that an area office manager must spend months understanding throughly each project before recommending foreclosure. Is this the kind of standard currently in operation?

Mr. CLAY. I don't think that is an extraordinary standard at all. I think on the contrary. As I indicated in the letter I sent to Assistant Secretary Simons requesting that the foreclosure request be held in abeyance, we spelled out some things we hoped to accomplish over a period of time. Because of the complexity of this problem, an area office manager, an area office director, in order to get those problems resolved, has to be personally involved. There is no question about it. This was an unusual project.

Senator PROXMIRE. The reason I ask is because, as I understand it, there are literally hundreds and hundreds of projects that are foreclosed and subject to foreclosure.

Mr. CLAY. But I didn't have hundreds and hundreds in my office——

Senator PROXMIRE. I understand that.

Mr. CLAY [continuing]. That were being foreclosed.

Senator PROXMIRE. I wonder if in each case you take 7 or 8 months——

Mr. CLAY. I took more time with some of them. For example, if you will bear with me, the Clifton Terrace issue became an issue with me because during staff review with the management staff, I asked them to surface to me those projects in our inventory that they considered troubled, which were seriously delinquent, which were under workout agreements. Then the Director of Housing and Urban Development arranged a meeting with the owners and managers of each project, which the record will show was held. It was during this exercise that I first came in contact with the owner of Clifton Terrace. Not only was I working on Clifton Terrace in terms of trying to forestall foreclosure, but with other troubled projects as well.

## OWNER'S FAILURE TO HIRE A PROFESSIONAL MANAGER

Senator PROXMIRE. In that December 1977 memo, Mr. Clay, you go on to say:

> In a meeting on October 6, 1977, we told the owner that she should proceed to hire a professional property manager and proceed with the plan which had been developed by Arthur Anderson Consulting firm.

I wonder if you could tell us a little bit about the Arthur Anderson plan. Our information is that there never was such a plan.

Mr. CLAY. I think I wrote to the owner, indicated to her and told her in meetings, that she would be required to hire a CPA and I specified that that CPA firm had to be one of the big eight. She then wrote me back and said she had undertaken conversations with Arthur Anderson, who she proposed to retain. I asked her for proof that these conversations were going on in a time frame to hire the firm. I then got a letter back from someone, I am not sure, but the record should show it, from someone connected with the Arthur Anderson firm indicating that they were working with Ms. Treadwell to come up with a scope of work for performing the requested order.

Unfortunately, we made several other requests to produce——

Senator PROXMIRE. Arthur Anderson indicated they were working with her on a potential contract which was never signed, is that right?

Mr. CLAY. At that point they didn't say, "potential contract which wasn't signed." They were in the developmental phase. As I was continuing to say, that contract was never consummated, even though we continually attempted to get her to execute the contract and to get the work done. That was part of the process.

Senator PROXMIRE. You point out in your 1977 memo that:

> Based on a review of past financial statements, my staff has determined that all expenses are either valid or we have requested reimbursements, which have been made by the owner.

Who on your staff made that determination? What was its basis in fact?

That statement seems to be clearly in error on the basis of what we know.

Mr. CLAY. I can tell you what I meant at the time that was written. At the time that was written, we had spelled out to the owner, based on the audit and based on our own staff review, expenses we thought were ineligible. We had requested information from the owner and documentation to justify those expenditures.

Jack Gifford, who had been assigned personally by me because he was the most senior servicer I had, reviewed those bills and made a determination, based on what we had requested, that the owner had satisfied us. That's the basis of that statement.

Here, 2½ years after, when other things have been discovered, if you ask whether we can say we were clearly in error, I can say we were. At that point he made his best professional judgment.

### OPTIMISM WAS NOT CONTRADICTED

Senator PROXMIRE. Mr. Simons, you quoted from an August 15, 1977, memo to Ms. Melkonian by Mr. Pfaender and said he did not contradict the area officer's optimistic prediction that operations can be stabilized within 90 days.

Let me read from the memo:

> I understand that Director Clay met with Secretary Harris shortly after making his foreclosure recommendation to me on June 20, 1977. Apparently that meeting resulted in renewed negotiations with the sponsor, Ms. Mary Treadwell Barry, which has

produced in Mr. Clay an optimism that project operations can be stabilized within the next 90 days, and we can then address the monumental task of curing the mortgage default.

Isn't it clear from this statement that Mr. Pfaender was hardly in a position to disagree with Mr. Clay's optimism?

Mr. CLAY. No.

Mr. SIMONS. No.

Senator PROXMIRE. I say that because it seems that up the line this was the Department's position.

Mr. SIMONS. What was the Department's position, what are you characterizing as the Department's position, Mr. Chairman?

Senator PROXMIRE. I will read the excerpt again:

> I understand Director Clay met with Secretary Harris shortly after making his foreclosure recommendation to me on June 20, 1977. Apparently that meeting resulted in renewed negotiations with the sponsor, Ms. Mary Treadwell Barry, which has produced in Mr. Clay an optimism that project operations can be stabilized within the next 90 days, and we can then address the monumental task of curing the mortgage default.

Mr. CLAY. I have not seen the document that you are reading from, but to say that—I know when I wrote I indicated I was optimistic we could do something in 90 days. I guess I resent the implication here that that optimism had to be tied to some meeting with the Secretary be- cause my optimism was based on things that had been accomplished between the time of that meeting and a decision that I had made that we could do some more things.

Between the time that I wrote that letter to Mr. Pfaender in a meeting with the Secretary, I had five or six meetings with the owner. Many things had happened. There had been a new spirit of cooperation on the part of the owner in terms of giving to the staff and responding to requests that they had been reluctant to do before. I think that really excused the issue in terms of tying—it sounds like I had been directed to be optimistic and that is nonsense.

Senator PROXMIRE. I am glad to have your emphatic rejection of that implication, but I wanted to ask the question because the document is here and that is what the document seems to imply.

### OFFICE DIRECTOR NOT TAKEN OFF THE CASE

Ms. Melkonian, according to Mr. Pfaender's testimony, shortly after an August 15, 1977, memo to you, you indicated that he was to drop the Clifton Terrace case and that you would now handle the Clifton Terrace case personally with assistance from Donald Myers—the HUD-Held Properties Division Director. I told Mr. Pfaender that it seemed odd that the Director of the Office of Loan Management, who had been critical of P.I.'s performance since the sale of the project in June of 1975, would be benched at a time when the condition of P.I. and the project were at a most critical stage and finally getting intense scrutiny from central office.

Why was Mr. Pfaender taken off the Clifton Terrace case in the fall of 1977 after being actively involved since June of 1975?

Ms. MELKONIAN. He was not taken off the case and I can only reiterate from the Assistant Secretary's testimony and adopt it as my own statement: "No one was ever removed from the case or in any way inhibited or restricted from acting on the case. Any statement to the contrary is simply not true."

Senator PROXMIRE. Mr. Pfaender testified to that effect before this committee on November 19.

Ms. MELKONIAN. I think he has to be asked to account for that statement.

### HUD CONTINUES TO WORK WITH OWNER

Senator PROXMIRE. Ms. Melkonian, as late as April 6, 1978, you indicated in a letter to the president of P.I. Properties that, and I quote: "It is our objective to work with you as owner of the project to address these problems and to avoid foreclosure." Why in the world was HUD still playing the game with P.I. 10 months after foreclosure had been initially recommended?

Ms. MELKONIAN. For the same reason that Mr. Simons indicated previously. It was my judgment that without a simple administrative record to move toward foreclosure, that the Department ran a high risk of encountering a very lengthy foreclosure procedure.

When I reviewed the case in December of 1977, after Mr. Clay asked Mr. Simons for direction on how to deal with the case, it was my judgment that there were many complicated issues of fact which Mr. Clay's office had been wrestling with in the previous 6 months.

Once the May audit report had come out and there was no indication at that time of any fraud, the area office worked to resolve the audit findings. When they came to the conclusion that that was not possible without major changes in HUD's relationship to the project, Mr. Clay asked us in the central office to review the case. I personally reviewed the case. It was, in my judgment, if we went to foreclosure at that time on the record that was then before us, that the issues of fact would drag on and on and on in lengthy foreclosure proceedings.

Our objective was to get control of the property and we could not get control of the property unless we had swift foreclosure.

So we took the time to develop that record and it appears that we were able at least to accomplish swift foreclosure when we did foreclose.

Senator PROXMIRE. Why weren't certain performance deadlines set in mid-1977 and why wasn't P.I. told that if they didn't meet those deadlines within a matter of weeks, you would foreclose or, at the very least, replace P.I. as the management agent?

Ms. MELKONIAN. I think, looking back on the record, clearly that was a major improvement we could have made. We could have set deadlines earlier. That was the way we looked at the case at the time, taking the May audit as a starting point, after an investigation—not an investigation, an audit—to determine whether or not any suspicion of the use of income of the project was justified and perhaps fraud was going on. When those fears were allayed in May of 1977, the area office made its judgment to continue to work with the owner, and it was an effort to do just that, to work with the owner. When the case was referred back to the central office, we took a harder look at it, with the idea specifically of how to foreclose, how to bring about a foreclosure, not just a lengthy foreclosure proceeding.

We could have recommended foreclosure at that point, put it right into the General Counsel's Office and then the Department of Justice. We could have, in December, recommended foreclosure. We chose not to because we did not think that would lead to a swift foreclosure, and we took 6 months extra when we did not know there was an embezzlement going on, if such an embezzlement did go on, we took 6 months to build a record on which we then foreclosed.

### "KENT FARMS" CASE

Senator PROXMIRE. Ms. Melkonian, in Secretary Harris' statement and Secretary Landrieu's statement, the *Kent Farms* case has been cited as one very important reason why HUD had to proceed cautiously with foreclosure. However, a quick look at that case shows that the fact situation there was quite different. For example, HUD had a moratorium on foreclosures at the time of the *Kent Farms* case and did not present a reasoned analysis as to why Kent Farm should be an exception to that moratorium. Was there any general moratorium in effect at the time foreclosure was recommended for Clifton Terrace?

Ms. MELKONIAN. That is correct. We did not cite that case in our testimony for those reasons. We cited that case to show that there was a high standard set in this jurisdiction for the administrative record that was reviewed by the court. What we felt——

Senator PROXMIRE. One of the reasons for the standard was that there was a moratorium.

Ms. MELKONIAN. No; that is not correct.

Senator PROXMIRE. The proposed foreclosure was an exception to the moratorium.

Ms. MELKONIAN. No; the part of the case that dealt with the administrative record dealt with the question of HUD's responsibilities under the Administrative Procedures Act. That is an ongoing responsibility. It is not applicable only to the *Kent Farms* case. That court found that this Department is subject to the Administrative Procedure Act. Therefore——

Senator PROXMIRE. Why was the moratorium mentioned?

Ms. MELKONIAN. There were many other aspects of that case that the court was dealing with. The one that was relevant to our situation at Clifton Terrace was the aspect dealing with the administrative record. That is why we made mention of it.

Senator PROXMIRE. Ms. Melkonian, although the court in the *Kent Farms* case enjoined the immediate foreclosure of the property, it did so only for so long as it would take HUD to provide a rational, consistent statement of its reasons for foreclosing on the project. In fact, the court refused to prescribe a workout agreement because, in its words, "HUD was tolerant, forebearing, and endlessly patient. It has not been shown to have been arbitrary, only insistent in protecting the Government's interests. It has certainly, on this record, exhausted alternatives."

Couldn't the standard set by the *Kent Farms* case have been easily satisfied in a matter of days or weeks in the case of Clifton Terrace by simply setting forth the reasons why HUD decided to foreclose—for instance, the fact that only four mortgage payments had been made in 3½ years?

The *Kent Farms* case would not seem to justify a 1-year delay in the foreclosure decision.

Ms. MELKONIAN. You are correct, if that was the only problem we were dealing with. The problem wasn't how to set forth the owner's failures, the problem was how to deal with the accusations by the owner that HUD had failed. If you remember, in our prepared testimony we recited the claims that the owner made about the Department's inability, or unwillingness, to perform on its obligations. Those were precisely the claims that the owner later raised in its defense to our foreclosure.

The record that we built between January and June was a simple record that isolated the owner's obligations so that, regardless of whether or not HUD had or had not fulfilled the claims that the owner was making against us, we would be able to point to very simple obligations that the owner had once more, after a final effort, failed to perform.

It was a record that could easily be presented in court, presented forcefully in court and it was, and I think the evidence of a successful strategy is that we did foreclose and we foreclosed swiftly.

Senator PROXMIRE. Mr. Simons, the General Accounting Office testified last month that as far as they could tell, there was no workout agreement reached between P.I. and HUD changing the mortgage payment schedule.

GAO went on to say that HUD had no specific standards as to when workout agreements should be negotiated with the owners of troubled projects behind in their payments.

Why wasn't a workout agreement reached with P.I. Properties as early as September of 1976 when it was clear that they were far behind in their mortgage payments and suffering serious financial problems?

Mr. SIMONS. I can't answer for September 1976, but I can say, looking at this project, that in attempting to develop a workout agreement, one of the first issues that would have to be resolved is what were the Department's obligations under the contract of sale. There were central issues between the Department and the owner regarding HUD's responsibilities and obligations with respect to this project.

Until those could be clearly determined and definitively determined, it was impossible to enter into a workout agreement, because those had to do essentially with the financial capability and feasibility of that project.

Senator PROXMIRE. Why don't you have any specific standards as to when it is appropriate to enter into workout agreements?

Mr. SIMONS. Under the policies which we put into effect, and I think Secretary Landrieu testified as to this, we feel it is essential that there be some workout agreement or approved plan between the owner and HUD in all projects on which we have an assigned mortgage.

We have been moving toward doing that.

Senator PROXMIRE. Do you have any time limitations?

Mr. SIMONS. There is a report due in January, but the time limit is one that it is supposed to be done as rapidly as possible. Our goal—let me tell you how we approach it—is that we want 100 percent of these projects under workout agreement or an approved plan.

[Clerk's note: The Department subsequently indicated the report was due sometime in 1980.]

Senator Proxmire. Why wouldn't it be a good idea to have a specific time period instead of simply saying it should be done "as rapidly as possible." As rapidly as possible could mean many months.

Mr. Simons. Each project presents a new set of problems. Some projects are very simple to get under a workout agreement. We are now doing a study which will be done in January to give us the basis for establishing certain time frames——

[Clerk's note: The Department subsequently indicated the study would be completed by the spring of 1980.]

Senator Proxmire. So you are working on that. You may have that by January?

Mr. Simons. We will have an internal recommendation for a reorganization of our approach for workout agreements and assigned projects.

Senator Proxmire. A member of the committee staff attended a Clifton Terrace Tenants Association meeting on November 16. At that meeting, Mr. Terry Chisolm, area office director, made a commitment to the tenants to move quickly toward reaching a definite plan for addressing the project's security needs and to immediately bring plans for improving the children's play areas at Clifton Terrace, among other things.

I also understand that the new management company has promised to, again, look into the problems associated with the leaking roofs at the project; to clean up the halls, and trash chutes; and to do something about either repairing or at least sealing off those vacant units affected by the fire 3 years ago. There was also a question about getting a licensed engineer on board to assist the project in routine maintenance involving the boilers, the electricity, and so forth.

Why weren't these actions taken months ago?

Mr. Simons. Let me just say this in general. When you deal with a troubled project, a project such as this, it would be very nice if by immediate action we could turn the whole project around. My experience—I come, as you know, from experience in the private sector in dealing with projects such as this, you are dealing with problems that range over a number of physical problems, some which are essential to the actual operation of it. Dealing with these problems is a time-consuming situation. It takes time.

In this project, we have taken care of the major mechanical systems of that project. We are taking steps to try and deal with all those problems which haven't been dealt with. I would like——

Senator Proxmire. Let me just challenge that statement. You have 45 units that are still sealed off because of a fire that took place 2 years ago. You foreclosed a year ago, and it would seem to me that it certainly would take several days or several weeks to remedy the situation, but to take a full year to make reasonable repairs to these units—the leaking roof, the burned-out, gutted-out section—seems to be excessive.

Ms. MELKONIAN. I can comment on that, Senator. After your visit to the project I personally, at the direction of the Assistant Secretary, went up to the project to see it, and also reviewed the record of the area office in dealing with the project, since the foreclosure. There have been many problems experienced in putting the project into good physical condition.

The principal goal at the time the Department took over was to make sure the project was functioning. When we took over we had major work done on the mechanical system, electrical system, the fire alarm, roof, heating-cooling system. All of that work is underway. The delay in accomplishing it has been in getting contractors to come up to the job and to have the contractors bid; to observe all of the Department's requirements to prevent us from paying more than we have to; that has also impeded us in moving swiftly. So we have taken these steps, we are continuing to work with good contractors, hopefully, now, to finish the work at the project.

Senator PROXMIRE. Can you do this for the record, Mr. Simons, if you can't do it now? Can you tell us as precisely as possible how much HUD has spent on the Clifton project as of today?

Mr. SIMONS. I will be glad to provide that.

Senator PROXMIRE. You have no estimate as to what that might be?

Mr. SIMONS. I would say between $5 and $5½ million, which represents less than $20,000 a unit. If this project can be saved, and I think it will be saved, it will cost slightly over $20,000 per unit.

Senator PROXMIRE. On June 30, 1978, Bryant and Bryant reported to HUD following a HUD-sponsored study that $1,350,000 worth of repairs to Clifton Terrace were necessary to bring the project up to snuff.

How much of this work have you funded since that report and how much remains to be done?

Mr. SIMONS. I will supply that for the record.

[The information follows:]

### HUD'S INVESTMENT IN CLIFTON TERRACE

The Department's investment in Clifton Terrace consists of three principal elements—the original insurance claim payment of approximately $4,177,000, the advances to the project during Pride's ownership, about $160,000, and the net cost of operation and repair since acquisition in August 1978, nearly $585,000 through September 1979. This outlay totals to $4,922,000, or less than $17,500 per unit for this 285-unit project. If, in addition, the unpaid mortgage principal balance carried on the Department's books as owed by Pride at the time HUD acquired the project, roughly $890,000, is added, then for accounting purposes the total is still under $6 million.

In June 1978, a consultant's preliminary general survey indicated that in its opinion there was $1.3 million of repair work to be done at Clifton Terrace. The Department never reviewed that report comprehensively to ascertain the accuracy of the figure or the need for the specific work suggested because it acquired the project soon after the survey was completed. Instead, since acquisition the Department has undertaken much of the actual major work needed at Clifton as well as routine maintenance and repairs. Repairs totaling $450,000 are in progress or completed as of October 31, 1979, including the repair of the major building systems—that is, electrical, heating, fire alarm, and air-conditioning, as well as the repair of the roof. The Department is committed to making Clifton Terrace a decent, safe, and sanitary place to live. The total cost of achieving that objective will be substantially less than the cost of providing comparable newly constructed housing at today's costs.

Senator PROXMIRE. Let me just say in closing, that it is clear from today's hearing that very serious mistakes have been made in the handling of the Clifton Terrace case, both by the owners—P.I. Properties, Inc.—and by the Department. It would be reassuring to think that this was a unique situation. However, Clifton Terrace does not appear to be an anomaly, but rather symptomatic of widespread problems in the handling of multifamily projects all across the country.

Since our first hearing in November, a committee investigative report on the HUD-held multifamily inventory has been released and the subcommittee staff has been deluged with calls from Boston, St. Louis, Rochester, N.Y., Eugene, Oreg., Chicago, Atlanta, and so forth—all from citizens telling of Clifton Terraces in their own backyards.

It has not been my intention in these hearings to point the finger of blame at any one individual, nor have I attempted to pursue the question of criminal activity, which is currently being addressed by the U.S. attorney. But I believe that the record to date has indicated that the HUD-held multifamily housing program has been debilitated by mismanagement, inadequate servicing of projects by both audit and program personnel, and inadequate policy guidance from HUD headquarters. And it is not clear that the patient is getting well.

In January, I intend to look into the systemic problems at the Department and discuss other troubled projects in the HUD inventory with officials of HUD, the GAO, and members of the Appropriations Committee's investigative staff. Hopefully, the end result will be a more efficient, better functioning operation.

Ms. MELKONIAN. Can I just make one comment on that, Senator?

Obviously, a statement like that is prepared before a hearing. The witnesses before you today made a very complete presentation of precisely what happened in the Clifton Terrace case, a very good analysis, I think, of what its own weaknesses were and also put before you a very complete record of the Department's accomplishments in the very areas you are talking about.

I do not think it would be fair to the Department or the people who work there not to make recognition of the fact in your statement. Clifton Terrace is not an example of mismanagement that spreads throughout the Department and it should not be used by this committee to characterize the work and the very good work of this Department.

Senator PROXMIRE. We will be getting into the larger picture in January. We had prepared this statement before the hearings, that is correct. We prepared it because I wanted to indicate that we recognize that we are not simply looking at one project. I think the responses here have been useful but I don't think they have disabused this Senator of the fact that Clifton Terrace was a mess and that very serious problems are indicated by Clifton Terrace.

I think it will be up to the people who read the transcript and have been present at the hearings to draw their own conclusions. I would certainly strongly disagree with the thought they have been disabused to any extent of the notion that there were very serious problems in HUD with respect to the handling of Clifton Terrace. As I say, we have an investigative report by the committee's investigative staff, which is the basis of the statement that I just made. I am not saying this off the top of my head. My statement is not based only on the hearings. You haven't had a chance to testify on what the situation is out in the country. HUD has presented very fine, general statements by its former Secretary and by its present Secretary. Mr. Simons has been very helpful and so have you.

I think you still clearly have a very serious problem in handling troubled properties. Even if I made no statement at all, the Secretary's statement points out the very tough problems that are faced by the Federal Government under these circumstances in providing housing for low-income people. It's a terribly difficult time. I think we have to work hard on the problem.

Hopefully, the hearings we have in January will help us come to some conclusion regarding HUD's performance.

Secretry Landrieu. Mr Chairman, first of all, neither Secretary Simon nor Melkonian need testimony from me as to their competence or character. Let me say I have worked with them now for 3 months. I can truthfully say I have not worked with more dedicated nor competent people than they in the Department. I can go beyond that and tell you that in terms of the personnel in that Department, the people are very competent and terribly committed. What I said in my opening statement was that we obviously didn't cover ourselves with glory in the handling of Clifton Terrace, but the assumptions and the innuendo that it was fraught with poor judgment, mismanagement, and fraud from the HUD perspective is indeed an exaggeration. We pointed out in the statement that in 1974 this country went through one of the worst real estate disasters since the Great Depression. Not only was HUD having great difficulty because we are handling properties that are by and large for the low- and moderate-income citizens of this country, but some of the most progressive, dynamic, and solid real estate development firms in this country folded up during that period of time.

It is in that light that HUD has received so many of these properties. HUD, in addition, is held to a standard far greater and far higher than that by the private development firms.

I have been in the private development business. I know the swiftness with which they can move, and the lack of social responsibility that they had in comparison to the ponderous way in which the Goverment must proceed, particularly when it is incumbent with the great social responsibility that we have.

I think the chairman's statement is unfortunate in that it may give unnecessary credence to some of the allegations that have been previously made, despite the fact that we believe that we have countered some of those allegations in our testimony and in our proposed statements.

It is difficult——

Senator Proxmire. Let me interrupt. I am terribly sorry, I haven't missed a rollcall since April 1966. I have the longest continuing record in the Senate. If I stay another 3 minutes I am going to miss my first rollcall since 1966. I know you don't want me to do that.

Supposing you take 30 seconds.

Secretary Landrieu. You go ahead, Senator. I personally, too, felt the statement was unnecessarily harsh with respect to this Department. I know how difficult it is to develop a system with some 17,000 employees, the vast majority of whom are terribly dedicated and hard working and to keep the spirit of that organization moving forward. When they believe we are making progress, to suggest that it is fraught with difficulty and no advancement has taken place, I think, is unfortunate.

I know the chairman to be a very honest and frank individual. I expressed my admiration for you in the beginning of this testimony. But I think the closing statement was a bit unfortunate and I would hope it would not be the permanent imprimatur of this committee.

Senator Proxmire. Thank you, sir.

## PREPARED STATEMENT

Senator Mathias has a statement he would like to include in the record.

[The statement follows:]

### Statement of Senator Charles McC. Mathias, Jr.

I think it would be helpful for the purposes of this hearing to recognize the important role that HUD-held properties play in providing a last resort housing option. Currently, HUD holds over 2,000 mortgages representing about a quarter of a million housing units with a mortgage balance of $3.7 billion. These numbers, however, in no way reflect the human component of HUD's program. I hope during our discussion today we will not ignore the importance and the potential—and I underline the term "potential"—of HUD to provide housing where it might not otherwise exist.

Now more than ever, the ability to keep projects in the housing inventories is critical. The lack of rental housing was called a national crisis in a GAO report released just 1 month ago. During the last 3 years, for example, there has actually been a net annual loss of rental housing and the Nation's rental vacancy rate is now the lowest it has been in a quarter of a century. Recent projections show that the rental market will get even tighter in the next few years. The consequences of this housing shortage translate to increased competition and demand for the shrinking number of existing units which push rents upward and thus ultimately increase housing costs. It is, therefore, extremely important that every housing unit that can be saved, be saved.

Because of our failure to achieve the goals established by the Housing and Urban Development Act of 1968 and because of the withdrawal of units from the rental market, low-income families find themselves in a desperate situation. In human terms, what this means is that 5 to 6 million low- to moderate-income families live in physically inadequate housing. These families are living under conditions characterized by a lack of some or all plumbing, inadequate kitchen facilities, inadequate sewerage, leaking roofs, loose or missing steps and inadequate or no heating. An additional 9 million families are living in conditions characterized by HUD as overcrowded or requiring a disproportion of a family's income to support. At a minimum, we have 14 to 15 million families in this country in desperate need of better, more affordable housing.

It is both HUD's policy and the intent of Congress—as specified in the Housing and Community Development Amendment of 1978—to minimize the involuntary displacements of persons from their homes and neighborhoods. I'm sure that in our hearing today, we will be exploring ways to assist HUD in fulfilling this mission and doing so in the most cost-effective manner possible.

## CORRESPONDENCE AND SUBMITTED QUESTIONS

Senator Proxmire. We have additional questions to which we would like to get further responses for the record from you if we could.

There is also an excellent letter that I have here from Mr. Maffin of NAHRO. You asked that it be included in the record, and I will do so.

[The letter and questions and answers follow:]

## LETTER FROM ROBERT W. MAFFIN, EXECUTIVE DIRECTOR, NATIONAL ASSOCIATION OF HOUSING AND REDEVELOPMENT OFFICIALS

December 4, 1979

Honorable William Proxmire
5241 Dirksen
Washington, D. C. 20510

Dear Senator Proxmire:

The purpose of this letter is to express a general concern of NAHRO about the possible effect of the Senate hearings currently being held on the Clifton Terrace development here in Washington on the production and management of publicly-assisted housing in general.

Too often, the opponents of publicly-assisted housing have taken advantage of an honest attempt to discover the causes that created unacceptable circumstances in a particular publicly-supported development and turned it into a broad condemnation of an entire program.

The diversity of housing assistance vehicles, and increasing reliance on the existing stock, require that many people and institutions be involved in the provision and operation of assisted housing. Inevitably, some situations akin to Clifton Terrace will come to light, and demand the closest scrutiny. Often, it is the mistakes that provide the best instruction for improving the system. We believe that congressional hearings on these circumstances can assist all of us who are concerned that public funds be properly utilized; to ferret out the administrative and regulatory practices that lead to unacceptable conditions.

However, NAHRO believes that at this crucial time when rental housing is in increasingly short supply, it is especially important that the situation at Clifton Terrace not become a vehicle to diminish public support and commitment to low and moderate income housing including its effective maintenance and management.

Thank you for your long and continued support for housing.

Very truly yours,

Robert W. Maffin
Executive Director

## Submitted Questions

It is alleged that on at least one occasion, HUD was billed twice for management fees. Evidently, this double billing was not detected through the normal process. What current procedures does HUD now have to protect the agencies against the recurrence of this type of problem?

Answer:

It should be noted that in HUD-held projects HUD itself is not billed for management fees. The project owner is entitled to and collects the income of the project, against which a management fee is billed either by an independent management agent or the owner as an owner/manager. HUD approves the level of such fees in advance and, ultimately, is responsible for determining whether or not project expenses are proper. Such double billing as is alleged to have occured in the Clifton Terrace account should have been detected and disallowed.

As part of HUD's monitoring of a project's financial operations, the Loan Servicer in the Field reviews a three-part Monthly Accounting Report which includes a schedule for establishing net income, a schedule of disbursements and a schedule of accounts payable. Existing handbook instructions (4350.1, Chapter 5, Sec. 3) stress the importance of promptly and carefully analyzing these reports.

The Department will continue to emphasize the importance of the systematic scrutiny and review of these monthly accounting reports. This monitoring will enable the Department to discover improper expense items or to identify situations requiring more detailed auditing.

### COMPUTERIZED ACCOUNTING SYSTEM

What type of computerized accounting system does HUD have to verify the legitimacy and accuracy of such claims and payments?

What difference or discrepancies in reported operating costs or income would trigger a project review?

What standards or criteria are built into your accounting system--such as expected per unit annual costs - that could be used to identify unusually high operating costs?

Answer:

While there are no computerized accounting systems now in place or planned which would verify the legitimacy or accuracy of payments made and reported through the monthly accounting procedures, the computerized financial tracking system, OLMS, is capable of "flagging" annual operating costs which vary from the norm for comparable projects. As presently designed, this system is capable of providing printouts of annual income and expense statements for the most recent three years for every insured and HUD-held project and can calculate average operating costs for similar projects, thus alerting field offices to project expenses which deviate from operating norms.

This system will be a valuable tool for identifying financial problems and the need for closer HUD oversight, such as an on-site review. Given adequate staffing and training, the on-site review, in which books, records, and invoices, etc., are examined, will provide the verification and explanation of questionable expenses or the need to take further action to remedy any discrepancies found.

The discovery of individual discrepancies, though assisted by automated, standardized systems, will remain within the province of the loan servicer. That person's experience, skill and diligence will be the tools most effective in fulfilling this vital responsibility.

How long will it take to implement a computerized accounting system and can this process be accelerated?

Answer:

The Department has no plans to institute computerized accounting systems for owners of insured or HUD-held projects. The function of project accounting is performed by its owner. HUD's function as insuror or mortgagee is to monitor overall management performance, of which the accounting system is one important factor. In keeping with this concern, OLMS provides a means of tracking project expense information. The implementation of OLMS is in progress. This system now has project data entered in 60% of our offices, and it should be fully implemented in the near future. OIMS will tie in with MIDLIS, another data system, to provide a loan servicer with complete project information. In the future OIMS will be enhanced to include HUD-owned properties, to trend historical expense data and to produce a project operating budget and rental schedule for the next year. In addition, the Department is currently working to improve accounting procedures on HUD-held mortgages. It is expected that the Office of Finance and Accounting's computer system will also feed the MIDLIS system.

As these automated accounting systems are implemented, they will give the Department valuable tools with which to manage the multifamily inventory.

## PERSONNEL NEEDS IN AREA OFFICES

The HUD Inspector General, GAO and the Senate Investigation Staff Report points out the need for more personnel in the Area Offices in order to adequately service and monitor the projects.

What has been the trend in staffing and work load in your Area Offices?

Answer:

The trend has been for the volume and complexity of workload to increase more rapidly than the staff, particularly experienced, skilled staff. However, during FY 1979, the Department developed new work measurement standards for most loan management functions. Unlike the previous standard, which based staffing on the number of projects within the field office jurisdiction, the new standard bases staffing on the time required to perform each function (e.g., process rent increases, make on-site management reviews, analyze annual financial statements). The new standard recognizes that the time required to complete a particular function as well as the total time required to service a project will vary according to the needs of the individual project.

We will be refining the work measurement standards in FY 1980 to reflect new policy directions, to provide more time for staff development, and to provide more time for staff intensive activities such as servicing troubled projects. We anticipate that the refined work measurement standards will show the need for even more loan management staff, and the Department will continue to seek to provide sufficient staff to perform all of its functions adequately.

To what extent would additional staff help in the early detection of management problems and misappropriation of funds?

Answer:

Staff increases should significantly enhance the Department's ability to detect problems early on, if for no other reason than that the staff will have more reasonable caseloads and be able to devote more time to individual projects. Additional and existing staff, however, must be provided with the necessary skills and resources in order to be truly effective. More bodies alone will not do the job. However, the Department is striving to provide the combination of more staff, improved skills and resources, and other supportive factors, such as increased use of sophisticated technology, which will allow field office staff to approach housing management more aggressively and with a preventive servicing strategy.

What is the grade structure and background of employees in a typical HUD Area Office?

Answer:

The typical grade structure for a loan management branch in a field office is as follows:

| | |
|---|---|
| Branch Chief | GS-13 |
| Supervisory Loan Specialist | GS-12 |
| Loan Specialist | GS-7-9-11 |
| Clerks | GS-3-5 |

The backgrounds of these employees vary considerably. Generally you would find a mix of seasoned veterans who have held a variety of jobs within the housing division and a newer group of relatively inexperienced specialists with college degrees in various fields.

How many in a typical Area Office have either an accounting, financial management or systems analyses background?

Answer:

Very few of the employees in the loan management branches in the field offices have educational backgrounds in accounting, financial management or systems analysis. Staff have developed skills to some extent in these areas through the Department's training programs, on-the-job training, or adult education classes. However, much more training will be done to provide Field staff with the skills to deal adequately with the complicated problems of troubled projects and to operate effectively in an adversary relationship with owners and their representatives, which is often the case. The development of staff with these proper skills is a high priority goal of the Department. We see this as an absolute necessity for the proper implementation of our programs.

## TENANT INPUT IMPORTANT

Does HUD believe that tenant input represents an important consideration in determining the quality of service being provided?

Answer:

Absolutely. HUD believes that tenant participation is extremely important in determining the quality of service being provided. This policy is represented in our new Part 401 and Part 402 tenant input regulations. These regulations will give tenants an opportunity to comment upon major actions that affect the day-to-day operation of the project such as a change in management agents or owners, rent increases, or major physical improvement plans.

The Department's legal relationship is with the owners of projects. However, the benefits of an active, concerned tenant body in making a project successful are well recognized by the Department, and we are sensitive to the need to provide an atmosphere in which tenant involvement can be useful.

Do you believe that tenant input can serve as an important early warning procedure to identify management deficiencies?

Answer:

Yes. Tenants are often in the best position to provide feedback on the success or failure of management and other aspects of HUD programs. While it is recognized that management cannot provide all that some tenants may want, HUD views tenant participation as a contribution to housing management and monitoring that no external system can replace.

The Housing and Community Development Amendments of 1978 require tenant input into key management decisions and we have proposed regulations to implement this requirement. In addition, present regulations require tenants' comments on rent increases and the sale of HUD-owned projects and these provide a further vehicle for involving tenants in decisions affecting them.

Is the formation of a tenant organization encouraged by HUD policy?

Answer:

HUD neither encourages nor discourages the formation of tenant organizations as Department policy. HUD does encourage its owners and their managers to develop good relationships with their tenants and suggests that this can be facilitated if a tenant organization is formed. We encourage HUD owners and their managers to cooperate whenever possible with existing tenant organizations and prohibit owners from discouraging such organizations. Central facilities which are located in HUD projects must be made available to tenant organizations upon request.

Is formal contact between HUD personnel and tenant associations required on a periodic basis by HUD policy?

Answer:

No. However, we meet with tenant organizations and their representatives to discuss Departmental policy and programs on a demand basis whenever possible. In addition, we encourage our Field Office personnel to meet jointly with owners and tenant organizations whenever invited to do so.

## HANDLING OF COMPLAINTS BY HUD

Are complaints and suggestions from tenants reviewed by HUD. How are these complaints handled, that is, who reviews them?

Answer:

This is a three-part question. As to complaints, the Field handles complaints received either by phone or by mail on an individual basis. If in doing so HUD determines that ownership or management has handled the problem insensitively or improperly as to HUD requirements, regulations or administrative instructions, HUD takes steps to resolve the tenant's problem while at the same time making sure the owner or manager is apprised of what is expected of them in the future concerning such problems.

As to suggestions for changes to make programs more responsive, we encourage the Field Office staff to refer recommendations to Headquarters, whether the advocate of these proposed changes is the tenant, owner, manager, or the HUD Field staff itself.

As to tenant input on those items requiring the owner to provide a vehicle for comment, HUD requires ownership and management to consider the input seriously and to provide us with copies of comments received. The Loan Servicer and the Loan Management Branch Chief are to review copies of the tenant comments prior to making a decision on the requested action.

It should be noted as well that Headquarters often receives complaints from tenants and their advocates. When this occurs, we research the matter thoroughly and provide redress as appropriate. Tenants and their representatives are also free to comment on proposed changes in HUD regulations and their comments are considered along with those from others.

Are periodic or early reports from Tenants Associations required by HUD Policy?

Answer:

No. HUD has no direct legal relationship with such organizations. We feel that requiring reports would be burdensome and overly intrusive. However, we are always open for comments and suggestions from tenant associations.

INVOLVEMENT OF TENANT ASSOCIATIONS

Does HUD Policy require tenant associations involvement in the selection of a management organization?

Does HUD Policy require that tenant associations prepare a formal annual management evaluation?

Answer:

HUD recently printed in the Federal Register a new procedure in 24 CFR Part 402 which requires that owners allow for tenant input and comment on the proposed managing agent and the management plan, among other major actions which could affect tenants and projects. While not requiring specifically that tenant associations comment on the selection of a management agent, this procedure will provide the opportunity for such comments and require that they be considered in making a selection. No formal annual management evaluation is required.

What is HUD doing to encourage more extensive involvement of tenant associations?

Answer:

Tenant input into rent increases requests is provided for by 24 CFR Part 401. In 24 CFR Part 402, HUD proposes to provide tenant input into other major actions, such as the selection of the management agent or changes in ownership. These new procedures should encourage the formation of tenant organizations to provide such input on an organized basis.

## SOLE SOURCE VERSUS COMPETITIVE BID

As I understand it, under existing law, the Secretary can negotiate sole source ownership and management contracts — which evidently was done in this instance. What are the current safeguards to assure that the Federal government is making the best possible deal under this sole source arrangement?

How is the sole source versus competitive bid decision made? Who are the major actors and what justification is required?

Answer:

Generally, the standards for establishing sole source arrangements in sales must balance the following objectives as set forth by 24 CFR Part 290 and Section 203 of the National Housing Act: a) Reduce the inventory of HUD-owned projects in a timely manner consistent with the goals of: 1) preserving or increasing the number of housing units available to and affordable by lower income tenants, 2) maintaining the existing housing stock in decent, safe and sanitary condition; and 3) preserving and revitalizing urban residential neighborhoods; b) consistent with meeting the above goals, to protect the financial interests of the government and to produce a satisfactory return to the mortgage insurance funds; c) to dispose of projects in a manner which is consistent with HUD approved housing needs and actions of local governments; and d) to dispose of all projects in a manner which minimizes the displacement of tenants.

Decisions must be made, in a manner which balances and chooses between these objectives when they conflict. For this reason the decisions on the "best possible deal" must be somewhat subjective. The Area Office must fully support its finding that the sole source negotiated sale is the best method to accomplish the Department's goals with a written determination by the Area Office Manager.

This recommendation is forwarded to Central Office where it is first reviewed by the Office of Multifamily Financing and Preservation (OMFP). If the OMFP finds the recommendation acceptable, it is forwarded to the Property Disposition Committee (PDC) for review and authorization. The

PDC consists of the Assistant Secretary for Housing-Federal Housing Commissioner (chairperson), the Deputy Assistant Secretary for Multifamily Housing Programs, the Director of the Office of Multifamily Housing Development, the Director of the Office of Multifamily Housing Management and Occupancy, the General Counsel, and the Deputy Assistant Secretary for Public Housing and Indian Programs.

The Department intends to develop more specific standards on what constitutes the proper basis for a negotiated sole source sale as opposed to a competitive bidding. Following Federal procurement regulations, the standards will require that the purchaser be the sole source from which the services required are available. The method will largely be restricted to tenant cooperatives and nonprofit groups when their ownership would be advantageous in maintaining lower income housing in accordance with tenant needs. Sole source negotiation is currently limited and will continue to be limited to formerly subsidized projects or sale to public agencies.

## ASSUMING NONPROFIT STATUS TO ASSUME MANAGEMENT

I understand that the firm wishing to assume management of Clifton Terrace was not a non-profit firm at the time it applied to HUD. However, shortly thereafter, it established a non-profit subsidiary to assume management.

How common is this situation -- the establishment of a non-profit status for the sole purpose of assuming management?

Answer:

It is a fairly common practice for profit-motivated owners to establish separate, but related, business entities for the sole purpose of managing the projects they own. However, non-profit owners usually manage the projects themselves or contract management to separate independent management firms.

In this case, the establishment of the non-profit was mainly for the purpose of qualifying for a negotiated sale, rather than for management. The Department had been involved in negotiations for the sale for several months before the Office of General Counsel informed the Assistant

Secretary for Housing Management that under the current procedures the sale could only be consummated with a non-profit entity. Given the Department's objectives and its previous actions and commitment, and considering Pride's reputation as a community service organization, it made sense to permit the late creation of the non-profit at that juncture.

What HUD policies or procedures are in place to assure that these newly created "non-profit" entities are really operated in the best interest of the tenants?

Answer:

HUD has adopted policies and procedures to protect the interests of tenants regardless of whether the owners and/or management are for profit, longstanding not-for-profit, or recently created not-for-profit entities.

Under Section 203 of National Housing Act and in regulations at 24 CFR 290 and 886, Subpart C, sale of a project such as Clifton Terrace would include Section 8 Housing Assistance for lower income tenants. Section 8 assistance requires the execution of a special Contract of Sale and a Section 8 contract between HUD and the purchaser. These contracts require that the purchaser operate the project and the Section 8 units in a manner prescribed by HUD. Through the regulations and contracts described above, the Department assures that the apartments remain available to lower income tenants and that they are managed properly.

In most instances, the sale would also involve a mortgage which is either FHA insured or directly financed by HUD as a "purchase money mortgage". In either case, the project would then be governed by Section 402 tenant input regulations requiring the owners of HUD-insured and HUD-held projects to give tenants an opportunity to comment upon major actions that would affect the day-to-day operation of the project (e.g. a change in management agents or owners or a major physical improvement program).

Moreover, Part 290 regulations give tenants in HUD-owned projects the right to provide input in the disposition process to assure that tenant interests are protected when the project is sold.

## ASSESSMENT OF TRIAL PERIOD

Before permitting PI Properties to assume ownership, you required a trial period. Generally, what factor does HUD consider in these trial periods?

Who reviews the performance during such trial periods?

What specific review, audits, resident surveys, on-sight inspections are used to review the trial?

Who are the major decision-makers involved in assessing the acceptability of the performance?

What safeguards, checks and balances exist in this assessment process?

Answer:

The negotiated sale of Clifton Terrace was unique in requiring such a trial period prior to assuming ownership. To our knowledge this technique was not used before and has not been used since. All owners and managers of HUD projects are continually monitored and evaluated to determine whether or not they are performing satisfactorily and corrective action is required wherever necessary.

In each case where a new ownership or management entity comes on the scene, a very subjective judgment must be made as to that entity's capacity to perform to HUD's standards.

Although there are normally no trial periods, as such, the management of all projects are monitored through reviews of monthly accounting reports, on-site visits, conferences with residents and discussions with the project manager concerning various phases of management and operation of the project.

The loan servicer and that person's branch chief are the major actors in assessing the acceptability of the performance of project management. The chain of command for decisions based on their recommendations, where higher decision making authority is required, is normally the Housing Director, the Area Manager and the Assistant Secretary for Housing/Federal Housing Commissioner.

What procedures must HUD follow to force a change in management if the owner does not desire such a change?

Answer:

If the managing agent's performance is unsatisfactory, HUD can require that the agent be replaced by the owner. The Regulatory Agreement between the Department and the owner reserves that right to HUD. If an owner resists this request it would be considered a violation of the regulatory agreement and the Secretary may give written notice to the owners that if such violation is not corrected to the satisfaction of the Secretary the Secretary may declare a default under the Regulatory Agreement and may attempt to foreclose on the project or have a private lender foreclose on the project if it is still insured.

In addition, the Secretary has the right to collect all rents and charges in connection with the operation of the project, to take possession of the project, to bring any action in court necessary to enforce any obligations of the Owners growing out of the project operation, and to operate the project in accordance with the terms of the Regulatory Agreement until the Secretary determines that the Owners are in a position to operate the project satisfactorily. The Secretary may also seek an injunction against a violation of the Regulatory Agreement or for the appointment of a receiver to operate the project. However, exercise of these rights, when contested by the owner, typically would involve a lengthy court struggle.

What problems does this present in terms of providing cost effective and responsive management?

Answer:

The problems of finding good management are not related to the right HUD has reserved to require owners to seek new management. The subsidized housing industry as a whole does not yet have as many managers in the private sector as are necessary to manage all the federally assisted housing in the inventory.

The critical problem in trying to find good management is that there are a limited number of good management agents available who are willing to take on the difficult job of managing complex troubled assisted housing.

### REVISIONS TO REGULATORY AGREEMENT CONSIDERED

Has HUD proposed legislation to resolve some of the problems presented by the judicial process?

Answer:

At present, the Department is reviewing the desirability and necessity of making revisions to the Regulatory Agreement to strengthen HUD's position in protecting its interests. There have also been discussions for changes relative to foreclosure laws to speed up acquisition and reduce the amount of time a distressed project remains in the hands of an uncooperative owner. While at this time there is no legislation proposed to resolve these problems, the Department intends to seek legislative relief if it determines that that is necessary.

What guidance have you received from the Congress, the courts, and/or the Administration in terms of weighing the human versus financial issues involved in foreclosure?

Answer:

The Department has faced a range of advice on this issue. The General Accounting Office has indicated that HUD should be more prompt and aggressive in its decision to foreclose. The Federal courts, on the other hand, have called for caution in HUD's use of foreclosure. Recent court decisions have held that the Department is bound to follow both the National Housing Act and the Administrative Procedures Act in reaching foreclosure decisions. As the U.S. District Court for the District of Columbia stated in a case preventing the Department from foreclosing on a mortgage that was $800,000 in default, "HUD is not simply a banker; free to foreclose on the basis of legal default alone." "(L)ack (of) financial promise ... alone is not enough to justify foreclosure."

The Senate went even further in its report on the Housing and Community Development Amendments of 1979, by directing HUD to use foreclosure only as a tool of "last resort" because it "is expensive and disruptive and signifies failure".

The Department is developing a comprehensive approach to the foreclosure process for both its decision-making and execution stages that will respond to these various concerns. It will continue to involve a detailed project analysis and documented decision-making procedure. If there is an alternative to foreclosure which is more beneficial to the project and the tenants and less costly to the Federal government, it will be explored. If, however, foreclosure is the best option available to resolve a project's difficulties, it will be pursued expeditiously and aggressively. The Department seeks to carry out the mandated intent of the housing programs which it interprets to be the provision of affordable, decent, safe and sanitary housing for low and moderate income persons. When other tools are more effective or less costly in achieving the same ends, foreclosure will not be pursued.

## FORECLOSURE GUIDELINES

What general guidelines, if any, does HUD follow in determining when a foreclosure is warranted?

Answer:

If the owner of a project is not cooperative in working to solve its problems, or the other tools and resources available to the Department to address a project's problems are not suitable, foreclosure will be considered warranted.

There are many reasons why a project may encounter financial difficulty, default on its mortgage obligations, and become assigned. One of the main reasons was stated by Senator William Proxmire in hearings before the Senate Committee on Banking, Housing and Urban Affairs in October 1977. He said that "at bottom the problem appears to be uncontrollable and rapidly increasing operating expenses. These costs have risen at a far faster pace than the incomes of the tenants who must ultimately pay for them." Thus, assuming compliance by the project owner with HUD's requirements, the Department's policy is that foreclosure should be used only when other tools available to save a project have been exhausted. If, however, one of the causes of a project's distress is an uncooperative, uncommitted owner who has no interest in achieving this result, then we view foreclosure as a useful option.

In those instances, where a foreclosure has been contested, what has been HUD's court record?

Answer:

The issue is not so much whether or not HUD prevails, because in most cases the government will eventually get the project back. The issue is how long that takes and how much the project suffers in the interim. The average time for foreclosure proceedings to be completed, when they are contested, has been two to three years. However, the recently revised bankruptcy statutes will continue to pose problems for the Department. HUD was denied an exemption to the provision which stays foreclosure proceedings when a project owner files for bankruptcy. While the full impact of this has not yet been realized, we are concerned that our ability to foreclosure and to control projects with uncooperative owners may be seriously hampered.

Please outline your foreclosure procedures, indicate the cognizant officials and the checks and balances in place?

Answer:

Existing policy states that HUD may foreclose when one or more of the following conditions exist:

1. Owner withholds funds, fails to maintain property and/or neglects mortgage payments.
2. Owner dissipates or diverts project income or assets.
3. Owner abandons property, occupied or unoccupied.

A field office may recommend foreclosure after completing an analysis of the project including a financial analysis (Form HUD-9815), and a physical inspection and holding discussions with the owner or mortgagor representatives in an effort to effect a reinstatement program. However, before recommending foreclosure, the field office mortgage servicing personnel are required to:

> Complete a comprehensive on-site management review including a physical inspection of the project; prepare a detailed project analysis which assesses causes of a project's problems, and the project's total needs for financial or other relief and resources required to eliminate those needs; and develop a relief plan for resolving a project's problem based on the management review, project analysis and discussions with the project's owner and management entity. If the relief plan indicates foreclosure is the desirable course of action, the field office then recommends foreclosure to the Director of the Office of Fianancing and Preservation. That official has the authority and responsibility to refer project mortgages to the HUD Office of General Counsel for foreclosure. OGC refers to the Department of Justice those actions subject to judicial proceedings and the Department of Justice forwards the case to the appropriate U.S. Attorneys for action. OGC refers to HUD Area Counsels foreclosure actions subject to nonjudicial power of sale proceedings.

The various officials at each stage of this process are responsible for assuring that the decision to foreclose is properly documented and that a reasonable basis exists for that decision.

## CONDITION OF CLIFTON TERRACE

Please describe the condition of the Clifton Terrace property since HUD took possession in June 1978.

Describe the condition immediately before possession and the current condition with specific reference to heating, air conditioning, lighting and the roof.

Also list the repairs and improvements made by HUD since June 1978.

Answer:

At the time HUD took possession of Clifton Terrace through a contested foreclosure proceeding, it was in unsatisfactory condition. There were hundreds of code violations, the owners had been threatened by the City with denial of an occupancy permit and the major operating systems were not functional.

Since acquiring the property HUD has been working to make the repairs necessary to put the project back into the decent, safe and sanitary condition it was in when it was sold to Pride.

This process has not been smooth and it has been fraught with unforeseeable difficulties and delays, such as not receiving any bids for repair work due to contractors' reluctance to work at Clifton Terrace. This requires HUD either to redefine the task and/or readvertise the job or to attempt to enter into negoitations for a contract to do the repairs, itself a lengthy process. Nevertheless, the Department has been able to repair the major operating systems, including the heating, electrical, fire alarm and air conditioning systems and is overseeing the final stages of the roof repair. After this is completed, repair of the vacant units suffering from fire and water damage can be accomplished.

In addition, new management was engaged for the project beginning October 1, 1979 and it is expected that it will be aggressive in pursuing the additional minor repair, maintenance and cosmetic work necessary.

## SUBCOMMITTEE RECESS

Senator PROXMIRE. The subcommittee will stand in recess.

[Whereupon, at 1:10 p.m. Wednesday, December 5, the subcommittee was recessed, to reconvene at 10 a.m. Wednesday, January 23.]

# MANAGEMENT OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT'S INVENTORY OF MULTIFAMILY PROPERTIES

WEDNESDAY, JANUARY 23, 1980

U.S. SENATE,
SUBCOMMITTEE ON HUD–INDEPENDENT AGENCIES,
COMMITTEE ON APPROPRIATIONS,
*Washington, D. C.*

The subcommittee met at 10:03 a.m in room 1318, Everett McKinley Dirksen Senate Office Building, Hon. William Proxmire (chairman) presiding.

Present: Senators Proxmire, Leahy, and Weicker.

## NONDEPARTMENTAL WITNESSES

### MULTIFAMILY HOUSING

Senator PROXMIRE. The subcommittee will come to order.

Today we will hear from three groups representing low-income tenants, as well as from the General Accounting Office, regarding shortcomings in the Department of Housing and Urban Development's handling of multifamily properties insured by the Federal Housing Administration and currently in the HUD inventory.

We will also be told by HUD what steps the Department is taking to come to grips with the many serious problems that currently exist in this area.

### CLIFTON TERRACE

Today's hearing is an outgrowth of a pair of hearings the subcommittee held late last year on HUD's mishandling of Clifton Terrace, a project in the District of Columbia. We will attempt to explore today whether the Clifton Terrace situation was simply an aberration in an otherwise well-run program, or whether it represents a symptom of a much wider problem.

### FACTS ON PROPERTIES IN DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT INVENTORY

A week ago I received a report prepared for the subcommittee at my request by the General Accounting Office. The report disclosed a number of unsettling facts regarding properties in the HUD inventory. Let me briefly summarize some of those facts:

According to the Internal Revenue Service, project owners can claim interest deductions on HUD-held mortgages even though the interest is not being paid. Deductions for unpaid interest could easily exceed $200 million.

Of 1,442 delinquent mortgages currently being held by HUD, 514 or 36 percent are more than 2 years behind on their mortgage payments. Twelve of these mortgages are over 4 years delinquent, are neither under a current workout agreement nor in foreclosure, and have a total delinquency of $17 million.

The average length of time from the date HUD's Office of Multifamily Financing and Preservation requests foreclosure until foreclosure is actually accomplished is 2 years and 7 months. In the meantime the owners can continue to take tax deductions for unpaid interest.

After foreclosure HUD has to spend an average of $600,000 per project in repairs to remedy the deterioration that occurs prior to foreclosure.

At the conclusion of our last hearing on Clifton Terrace, I was taken to task by Secretary Landrieu for saying that I believed the record to date indicated that the HUD-held multifamily housing program has been debilitated by mismanagement, inadequate servicing of projects by both audit and program personnel, and inadequate policy guidance from HUD headquarters. I want to stress that I was talking about the situation as it existed at that time—about 1 month ago—and not about the steps HUD plans to take to improve the servicing and auditing of these projects. My experience has been that Federal agencies in general and HUD in particular tend to promise a great deal more than they can deliver.

In any event, I invite all those present here today and all those who will read about this hearing to draw their own conclusions about HUD's performance after the facts have been laid out on the record.

## EXCERPT FROM OPINION IN "FALZARANO V. UNITED STATES OF AMERICA"

Before we hear from our first witnesses, who will speak for FHA Tenants United, a Chicago group, I would like to quote from an opinion handed down by the U.S. first circuit court of appeals in *Falzarano* v. *United States of America* less than 4 months ago—on October 2, 1979. In that case, the court found that tenants do not have the power to require HUD to enforce its own regulations, a decision that I think is ill-considered. Even while finding in favor of the Department's position, however, the judge had this to say about the Department's performance:

> The picture which emerges of HUD's treatment of the tenants' complaints is not conducive to confidence in the administrative machinery's ability or willingness to be responsive and responsible to persons dependent upon it for a fair resolution of their problems. This lack of confidence is in no way dissipated by the treatment of the case in HUD's brief to this court. We hope HUD will be mindful of its duties and solicitous in carrying them out.

## STATEMENT OF SUSAN TAYLOR, FHA TENANTS UNITED

## ACCOMPANIED BY LINDA LINDSEY, PRESIDENT, FHA TENANTS UNITED

### TESTIMONY ON BEHALF OF TENANTS IN FEDERALLY SUBSIDIZED BUILDINGS

Senator PROXMIRE. Our first witness is Ms. Susan Taylor, who represents FHA Tenants United and who is accompanied by the president of that organization, Ms. Linda Lindsey. We are glad to have you both with us today. I hope that you can keep your statement as brief as possible for we have a number of witnesses on the agenda. If you could confine your remarks to 10 minutes, we would very much appreciate it.

We will let you know when you get to 9 minutes so you can summarize your testimony. We do have a number of witnesses.

I understand our fourth witness today has an appointment with the Vice President.

Go right ahead.

Ms. LINDSEY. I am Linda Lindsey, president of FHA Tenants United.

Before I ask our director to speak, I would like to thank Senator Proxmire and the members of this subcommittee for inviting us to testify on behalf of the thousands of tenants living in federally subsidized buildings. We are honored to be here.

### FHA TENANTS UNITED

FHA Tenants United is a 2½-year-old umbrella organization for approximately 15 tenant councils in various HUD-subsidized buildings in the Chicago area.

The board of directors is comprised of a diverse group of tenants including a 79-year-old retired saleswoman, a well-known blues musician, a welfare mother, a high school math teacher, a retired secretary, and a computer analyst.

The board is a testimony to the diversity of the population in these buildings—black, Chinese, Filipino, white, Jewish, East Indian, Latino—old and young alike. This unique group of tenants is one result of the rapidly growing housing crisis which has brought poor, working, and middle-income tenants together.

Our organization has been documenting and fighting abuses in HUD-subsidized low- and moderate-income projects for more than 2 years.

### MISMANAGEMENT, CONFLICT OF INTEREST, AND ABUSE

Although some of the buildings we will talk about are not in the HUD inventory, we want to bring these instances of mismanagement, conflict of interest, and abuse to your attention.

We believe that if action is not taken to curtail these practices, buildings which are not currently in the HUD inventory could be soon. The results of this abuse directly affect the safety and well-being of hundreds of thousands of tenants. The bulk of the financial burden of this mismanagement is placed on the people least able to afford it—low- and moderate-income tenants—through sharply escalating rents.

We hope that these hearings are the first step in recognizing the voice of tenants and the beginning of their participation in decisions that affect their lives.

Thank you, Mr. Chairman. I would now like Susan Taylor, director of FHA Tenants United, to present specific examples of fraud, abuse, and mismanagement taking place in the Chicago area.

Senator PROXMIRE. Ms. Taylor, go right ahead.

Ms. TAYLOR. Thank you, Ms. Lindsey.

Our purpose here today is to give testimony about a subject that is of vital concern to ourselves and thousands of tenants who are adversely affected by the actions of HUD.

I have a prepared statement. May I proceed?

Senator PROXMIRE. Yes. Go right ahead.

### 810 WEST GRACE BUILDING CONVERSION

Ms. TAYLOR. The five examples I will present typify practices common to the management of HUD-subsidized properties. One situation demands immediate attention. A major conflict has erupted at 810 West Grace over the conversion of this moderate-priced rental building to a high-priced cooperative. For years, 810 West Grace has been plagued with severe structural and maintenance problems, including roach and rodent infestation, huge hunks of concrete falling from the exterior of the building, heating problems, elevator breakdowns, and more.

In addition, a black mosslike fungus grows on interior walls as a result of design deficiencies. Under pressure from tenants to rehabilitate the building and make it more habitable, the owners threatened HUD with default in order to avoid the responsibility of solving the problems created by their negligence.

The general partners, one of whom is the architect of 810 West Grace, sold the building at $1.3 million profit to a cooperative converter. They retained the right to choose the company that would receive the $2.5 million rehabilitation contract. The contract was awarded without competitive bid to the company of which the architect and former general partner is vice president.

In an attempt to stop the co-op conversion, tenants went on rent strike on November 1, 1979. The monthly housing expense of this cooperative would be too costly for present tenants and would cause a displacement of the majority of them. Tenants also strongly believe that the purchase of a share of a building in such poor condition should not be imposed upon them, particularly when the person given the rehabilitation contract is responsible for the building's present condition.

In spite of HUD's knowledge of lack of competitive bidding, conflict of interest, and strong tenant opposition, HUD has continued to give full support to conversion. At this moment, tenants are facing eviction for refusing to be the victims of this scheme. This conversion must be stopped.

### 4550 NORTH CLARENDON APARTMENTS

4550 North Clarendon was designed by the same architect who designed 810 West Grace. Clarendon, too, has black fungus in over 80 percent of the corner apartments. Many of the apartments have severe water leakage, heat loss, and roach infestation. These symptoms worsen each year and are a major cause of the growing vacancy rate as more apartments become uninhabitable.

In spite of the poor rental conditions, the rents are among the highest of the subsidized rentals in the area.

In January 1977, an illegal loan of $125,000 was taken out of the project as a personal loan to an owner. Before the Inspector General discovered the loan, the supposed cash flow problem of the project caused HUD to grant permission for a 12-percent rent increase.

The suspension of mortgage principal payments and repayments to the replacement reserve account for 1 year were also approved. Although it appears the loan was fully repaid in October of 1977, the general partner paid no interest on the loan, received no penalty for his action and, in fact, was rewarded with a 12-percent rent increase, as well as deferment of his obligatory payments.

If actions such as these go unpunished, what is to prevent them from happening again and again?

### 510 WEST BELMONT APARTMENTS

The predominantly elderly population at 510 West Belmont has taken on some of Chicago's most powerful real estate barons who have successfully devised a financial strategy to pressure HUD. As early as 1973, severe design deficiencies were noted in the windows and roof, causing water infiltration in over 50 percent of the apartments. HUD's orders to correct these problems were ignored. In 1978, management applied to HUD for a 25-percent rent increase. Tenants, determined to force management to make necessary repairs, organized and pressured HUD to make the rent increase contingent upon approximately $280,000 in necessary repair work. The landlord, in turn, stopped paying his mortgage and instead put $106,000 of project funds into an escrow account. The owners finally agreed to become current in their mortgage in exchange for obtaining a flexible subsidy grant in the amount of $898,000.

In applying for this grant, owners spent $25,000 in legal fees as well as $14,000 in auditing and will spend $24,000 for the supervision of these contracts, a total of $63,000. These three costs were passed on to the tenants in a 10-percent rent increase approved by HUD to become effective in March of 1980.

### HIL'CREST APARTMENTS

HUD holds the mortgage on Hil'Crest Apartments in Aurora. Hil'Crest is a three-building complex. It is roach and rodent infested. It has entrance doors with no locks, apartments with collapsed ceilings, torn and filthy hallway carpeting, and more. The owner-manager's treatment of tenants can only be described as cruel. For example, electricity in various apartments has been turned off for as long as 2 weeks simply because delay of welfare checks made tenants late with their rent. The owner-manager was caught by HUD taking over $65,000 out of the project to pay his wife, daughter, and himself fees and salaries in violation of the terms of the management and regulatory agreements. In spite of HUD's orders to pay back this money in 1976, none was. HUD later devised a variety of ingenious methods to excuse these improprieties. The Inspector General was asked by FHA Tenants United to investigate the severe financial mismanagement. His report was inaccurate and incomplete. The report states that a recent request for a rent increase was justified based on a 1978 certified audit report. The 1978 audit as well as the two preceding it were not certified. The owner's CPA could not certify his client's audits. We are appalled at what appears to be collusion among HUD, the owners, and the Inspector General to cover up the abuse and mismanagement taking place at Hil'Crest. We have every reason to believe that excessive salaries are still being given to family members. Although we reminded the Chicago area office that approval of a rent increase based on an uncertified audit is in violation of its own regulations, HUD is presently considering such a request.

### 533 WEST BARRY APARTMENTS

In 1975, HUD ordered the owners of 533 West Barry to lower rents because of a rental overcharge and because expenses had decreased. The action was not taken. Instead, the owners and HUD met and agreed that a rent increase would be applied for and approved by HUD. A few years later tenants organized, discovered the overcharge and pressured HUD to have the $42,000 returned to them. As a result of continued meetings, protests, and demonstrations, HUD wrote to the Inspector General on April 18, 1977, and stated: "It would appear that the project rents were increased based on possible subterfuge."

Finally, in 1978, management returned the overcharged $42,000 to the tenants. Tenants also examined the financial records of the building and raised numerous questions about various expenses that were paid from projects. These included such costs as political contributions, memberships in unrelated organizations, loans to other buildings, and more. In addition, there were some persistent maintenance problems that the predominantly elderly tenants had complained about for years. The apartments at 533 West Barry have a strong tenants organization which has maintained a vigilance over the financial condition of the building. The tenants have forced HUD to deny one rent increase and reduce two other requests because they have proven that cost efficiencies could be made.

Senator PROXMIRE. Ms. Taylor, could you summarize as much as you can in a minute or so. We have the documentation before us. If you would like to add something, feel free to.

### LOW- AND MODERATE-INCOME HOUSING

Ms. TAYLOR. Low- and moderate-income housing is not an impossible mandate of Congress. By placing the interests of tenants first it can be a reality. Presently this is not the case. We believe that HUD has failed to protect the interests of tenants in these buildings, not because of bumbling or incompetence, but because HUD's primary interest is in protecting the insurance fund. The real estate and mortgage developers have taken over the multifamily housing program and subverted the intent of Congress. The National Housing Act was passed by Congress to provide subsidies for low- and moderate-income people. Instead, the bulk of these subsidies are going directly to the developers and bankers who are now making policy for HUD. There are two examples of this. The most recent is the flexible subsidy program which was intended by Congress to preserve the low- and moderate-income character of troubled buildings. The other is HUD's interest in converting rental units to cooperatives which further shrinks the rental markets. There are, indeed, many HUD regulations and policies that pay lip service to the need for tenant participation in these projects.

In the final analysis, only through a strong tenants organization with full negotiating power to curtail expenses and the power to fully scrutinize the expenditure of Government dollars will the financiers' stranglehold on HUD be broken. It was for tenants that Congress passed these programs.

Senator PROXMIRE. Thank you very much. I apologize for limiting your oral presentation, but we are working under the pressure of time. I am sure you understand that.

### TENANTS' ORGANIZATION

Ms. Taylor, you represent a tenants' organization in Chicago. How many tenants belong to your organization?

Ms. TAYLOR. We represent approximately 10,000 tenants, but only in the buildings that we have tenant organizations, and that is about 10,000 people.

Senator PROXMIRE. Do you feel that the buildings where the tenants you represent reside are fairly typical? Are they a cross section? Are they unusual in any way?

Ms. TAYLOR. No, they are not. Our organization is a very, very typical representation of the tenants in the Chicago area.

Senator PROXMIRE. During HUD's appearance before this subcommittee on December 8, Deputy Assistant Secretary Marilyn Melkonian said:

> Clifton Terrace is not an example of mismanagement that spreads throughout the Department and it should not be used by this committee to characterize the work and the very good work of this Department.

### HOUSING PROGRAMS MANAGEMENT

Secretary Landrieu also testified that—

> Neither the individual project nor projects of concern to the committee today, nor any other issues that have been raised, are grounds to doubt the basic integrity and soundness of the housing programs or the overall competency of HUD's management.

The Secretary went on to say that HUD has used aggressive, preventive servicing procedures developed for the flexible subsidy program to cover all troubled projects regardless of the method of dealing with the project. In other words, HUD seems to be saying that Clifton Terrace was the exception and that HUD has turned the corner in its handling of multifamily housing projects since 1977.

In your experience in the Chicago area, is it your opinion that HUD's management and servicing of multifamily housing projects has significantly improved over the last 2 years?

Ms. TAYLOR. No, sir. I am afraid I would say quite the contrary.

Senator PROXMIRE. How long have you been in your present position?

Ms. **Taylor**. The organization has been organized for 2½ years. We have found case——

Senator **Proxmire**. You don't think there has been any significant change in the last 2½ years? Things are about the same?

Ms. **Taylor**. In my opinion, no.

### HIL'CREST APARTMENTS

Senator **Proxmire**. In your detailed statement, you point to the Hil'-Crest Apartments as perhaps the most flagrant example of abuse and mismanagement by an owner/manager that went unpenalized by HUD. You allege that since the mortgage was assigned to HUD in August of 1976, HUD has failed to react responsibly to abuses such as the failure of the owners to submit audited annual financial statements or monthly accountings and the payment by the owners of improper salaries and fees totaling more than $65,000. You also point to HUD's failure to initiate an audit of the project despite its apparent knowledge of these and other abuses. Then you claim that HUD approved a rent increase without proper notification and in 1977 excused the entire $65,000 debt owed to the project by the owners through a number of questionable means. You are particularly critical of HUD's regional inspector general's efforts to review those abuses. You even go so far as to allege that HUD's Inspector General was not only inaccurate, but appeared to be in collusion with the owners to cover up the mismanagement taking place at Hil'Crest.

Could you elaborate on the Inspector General's role in the Hil'Crest project and tell us in general what your experience has been with the HUD Office of Inspector General in projects you have represented in the Chicago area?

Ms. **Taylor**. Because the HUD Chicago area office failed to initiate any kind of investigation, FHA Tenants United met with the Inspector General for investigations and requested that an investigation and audit be done of the Hil'Crest project. The report of the Inspector General came back. It was incomplete, to say the least and, in fact, it was inaccurate in that it stated that based on the certified audit report, a rent increase request would have been justified. In 1976, 1977, and 1978, the owner's CPA was unable to certify his client's audits. For the Inspector General to make a mistake like that—I can't explain it, Senator. It is either incompetence——

### 810 WEST GRACE APARTMENTS

Senator **Proxmire**. The project that is apparently receiving the most attention in Chicago these days is 810 West Grace, where tenants are currently embroiled in a rent strike. According to your testimony, the project was sold for $5.6 million and HUD is currently insuring a new mortgage for $10,102,400.

Ms. **Taylor**. Yes.

Senator **Proxmire**. You allege the previous owners, one of whom was the architect who designed the building with the structural defects, retained the right, as sellers, to choose and supervise the architects and construction company which would receive a $2.5 million rehabilitation contract at West Grace.

Ms. TAYLOR. Yes.

Senator PROXMIRE. Furthermore, you claim the contract was ultimately awarded sole source to the firm for which the original architect was serving as vice president. In other words, a former owner, who shared in a $1.3 million profit on the sale of West Grace, is an officer with the firm being awarded $2.5 million to rehab the project and convert it to a cooperative. Apparently this arrangement was made over the objections of the tenants and with HUD's blessings; is that right?

Ms. TAYLOR. Yes.

### CONFLICT OF INTEREST

Senator PROXMIRE. Are you aware of any HUD regulations that might have been violated as a result of that arrangement?

Ms. TAYLOR. Yes, I am.

Senator PROXMIRE. Could you outline for the subcommittee specifically why you feel this sole source rehabilitation contract might constitute a conflict of interest?

Ms. TAYLOR. Yes. The HUD cooperative handbook, section 4550.1, states:

> An independent attorney, architect and management agent must be used. There must be no identify of interest between a provisional board and the builder or seller of an existing project or with any other party that would adversely influence the cost of the project.

In addition, the same handbook states that the supervisory architect must be in no way associated with the builder or other parties seeking to derive a profit from the project.

Senator PROXMIRE. The situation you describe seems to be in clear contradiction to that provision.

### 810 WEST GRACE BUILDING COVERSION

It is also my understanding that West Grace project is being proposed for conversion to a cooperative despite the fact that until the rent strike this particular housing project was not in default.

Ms. TAYLOR. It was not in default.

Senator PROXMIRE. If the conversion goes through, about 260 low-income rental units would be affected, as I understand it.

Ms. TAYLOR. Yes.

Senator PROXMIRE. What was HUD's rationale for going ahead with plans for converting the project to a cooperative when the project was not in default?

Ms. TAYLOR. Senator Proxmire, that is a mystery. The closest I can come to explaining HUD's rationale is to quote from a recent newspaper article in the Chicago Tribune which quotes Area Director Binford. The article states:

> Fisher's, who is the converter, idea of cooperative conversion, Binford said, was the only alternative to a move by HUD to foreclose on the property, a process that would take 3 to 4 years of litigation and, in the meantime, would mean that the building would only deteriorate further. In addition, Binford acknowledged that much of the dispute at 801 West Grace could have been avoided if tenants had been informed in advance that their building was changing ownership and might be made into a co-op, but he said he would not handle it differently if it is done again.

## NORTH CLARENDON PROJECT

Senator PROXMIRE. Let me ask you about another troubled project you point to in your testimony, the North Clarendon project in Chicago.

Ms. TAYLOR. Yes.

Senator PROXMIRE. According to your statement, one of the project owners borrowed $125,000 from project funds in January of 1977.

Ms. TAYLOR. Yes.

Senator PROXMIRE. The owner requested and received from HUD a deferment of the payment of $3,039 per month to the reserve for replacement fund for a year in June of 1977 and requested and received from HUD a deferment of principal payment for 12 months in August of 1977. The management company requested and received HUD approval for a 12-percent rent hike in June of 1977. Apparently the HUD Inspector General, under pressure from the tenants, investigated this activity and ordered the loan repaid. The loan was repaid, but without any interest, and neither the rent increase nor the deferment of obligatory payments were rescinded.

During your deliberations with HUD, what specific rationale did HUD personnel give you and the Inspector General for allowing the personal loan to be made and for allowing forbearance on both the principal payments and reserve contributions?

Ms. TAYLOR. HUD gave no rationale.

Senator PROXMIRE. They gave none? Did you question them on it? Did you ask why they allowed this?

Ms. TAYLOR. Yes.

Senator PROXMIRE. They gave you nothing.

I want to thank you very much. I think you have made a very strong case. I am interested in hearing the Department's reaction to your testimony.

[Documentation of the testimony of FHA Tenants United follows:]

## Statement of Susan Taylor, FHA Tenants United

We wish to thank Senator Proxmire and the members of the HUD-Independent Subcommittee for inviting us to testify on behalf of the thousands of tenants living in Federally subsidized buildings. We are honored to be here.

FHA Tenants United is a two-and-a-half year old umbrella organization for approximately 15 tenant councils in various HUD subsidized buildings in the Chicago area. The Board of Directors is comprised of a diverse group of tenants including a 79 year old retired saleswoman, a well-known Blues musician, a welfare mother, a high school math teacher, a retired secretary and a computer analyst. The Board is a testimony to the diversity of the population in these buildings -- Black, Chinese, Philippino, White, Jewish, East Indian, Latino -- old and young alike. This unique group of tenants is partially the result of the growing crisis in housing which is bringing poor, working, and middle income tenants together to fight some of Chicago's most powerful real estate barons and HUD, which has failed to protect the interest of tenants.

FHA Tenants United is funded from tenant memberships and fund-raising activities as well as some private foundation grants. It has a staff of two and an active Board of Directors.

The organization has been documenting and fighting abuses in HUD subsidized low and moderate income projects for more than two years, at the request of the tenants who live in the projects. Although some of the buildings we will talk about are not in the HUD inventory, we want to bring these instances of mismanagement, conflict of interest, and abuse to your attention. We believe that if action is not taken to curtail these practices, those buildings which are not currently in the HUD inventory could be soon.

The results of this abuse directly affect the safety and well-being of hundreds of thousands of tenants. An enormous burden is being placed on taxpayers through the HUD Insurance Fund, yet the bulk of the financial burden of this mismanagement is placed on the people least able to afford it -- low and moderate income tenants -- through sharply escalating rents.

Following are some examples of the kind of abuses which we believe to be widespread.

### 810 WEST GRACE

810 West Grace is a 260 unit highrise that is presently in the midst of one of Chicago's bitterest rent strikes. The building has severe structural defects and other severe maintenance problems. The most significant symptom of the structural defects is a black moss-like fungus which grows around windows and, in some cases, on complete interior walls (see Page 2A).

This fungus growth is a potential health hazard, particularly in a building with hundreds of children. An independent architect who inspected the building at the request of tenants stated that the apparent reason for the fungus is that plaster was applied directly to masonry. He also informed us that the consequences of this technique have been known to architects for 30 years. Other serious maintenance problems in the building are: roach and rodent infestation, huge chunks of concrete missing from the face of the building, heating problems, elevator breakdowns, and more.

The rents in this building are significantly higher than in other subsidized buildings in the area and, as a consequence, most low income tenants are unable to afford to live there. The tenant union has raised some serious questions regarding financial mismanagement of 810 Grace, including an improper distribution in 1977 which HUD found out about in May, 1978, and which was never returned to the project (Appendix A).

In August of 1979 management applied for a rent increase three months after HUD approved a $30 per month rent increase. Tenants organized and succeeded in stopping that increase. On October 26, 1979 tenants at 810 West Grace were notified that their building "is and will be a cooperative". No information was made available to the tenants about what this would mean to them. On October 31, a group of tenants met with a HUD official in an attempt to obtain more information about the conversion. They received no information at HUD, and as a result, voted to go on rent strike in order to get the information necessary to make an intelligent decision with respect to buying, or not buying, a share of the building. Now that the rent strike is in its third month, it has become obvious why so little information was provided to tenants.

Rents at 810 West Grace are presently $191, $238, and $277 for one, two and three bedroom apartments respectively. Under the co-op plan the monthly housing costs will be $372, $462 and $546 for the same apartments. Section 8 subsidies will be available to anyone who is eligible. Very few tenants are eligible for Section 8 and for many of those who are, 25 percent of their income is more than they presently pay.

810 WEST GRACE

The previous owners of the building had a $4.3 million mortgage on the building. They sold it for $5.6 million. The new mortgage is $10,102,400. The total down payment on the mortgage is $558.

One of the General Partners (who sold the building), James Loewenberg, is the architect who designed the building with the structural defects. When the owners sold the building they retained the right, as sellers, to choose and supervise the architects and construction company which would be awarded the $2.5 million rehabilitation contract. With no competitive bidding, the contract was awarded to the construction company of which James Loewenberg is Vice President. There was also no competitive bidding for the conversion contract awarded to a co-op conversion company which will probably make $600,000 in the next three years from the conversion. The rehabilitation contract, in being granted on a no-bid basis to a former owner, represents, in our opinion, an extreme conflict of interest. We find it incredible that HUD would allow these unprofessional, questionable practices to take place with more than $10 million of taxpayers' money at stake.

Upon the request of tenants a meeting was held (to mediate this strike) with the HUD Area Manager at which time he was informed of the conflict of interest, lack of competitive bidding, and failure to properly notify tenants. Yet, he completely supported the conversion. At the same meeting, the HUD Area Manager threatened and verbally abused tenants. This behavior is unfitting a public official.

The tenants at 810 West Grace are on rent strike because HUD has failed to protect their interest. They had no other recourse to save their homes. At this very moment, tenants at 810 Grace are facing eviction for trying to stop the co-op from displacing the 260 families who live there. A full investigation into the manner in which this co-op conversion took place is necessary.

## 4550 NORTH CLARENDON

This building is a 500 unit twin-towered highrise on Chicago's North side. It has long standing maintenance problems. All apartments are roach-infested. Over 50 percent of the apartments have severe water infiltration from the walls, windows, ceilings, floors or joints thereof. Despite an adequate security budget, vandalism to cars and other tenant property occurs regularly.

This building has construction defects, the symptoms of which are: perpendicular walls that do not join, water leakage in over 50 percent of the apartments, heat loss in certain areas, and black moss-like fungus growth in approximately 80 percent of the corner apartments. The Clarendon building was designed by James Loewenberg, the same architect who designed 810 West Grace (which, as previously reported, also has black fungus). These symptoms worsen each year and are a major cause of the growing vacancy rate as more apartments become uninhabitable.

In addition, the Clarendon building has been mismanaged and has among the highest rents of any subsidized building in the area. In fact, this building has rents which exceed the market value for the surrounding neighborhood.

On January 1, 1977, project funds in the amount of $125,000 were disbursed to a General Partner and classified as loans. These loans are contrary to the terms of the Regulatory Agreement. Shortly after, the management began claiming that the building had a cash flow problem.

On June 8, 1977, HUD approved the agent's request for deferment of $3,039 per month to the Reserve for Replacment fund for a 12 month period. On August 29, 1977, HUD approved the agent's request for deferment of principal payment for a 12 month period.

On May 17, 1977, while $125,000 was out to a General Partner for a personal loan, management applied to HUD for a rent increase, again claiming a cash flow problem. A 12 percent rent increase was approved by HUD on June 29, 1977.

Under pressure from tenants, the Inspector General audited this building (Appendix B), discovered the "loan", and ordered it repaid. It appears that the loan was fully repaid as of October 21, 1977. It also appears that the General Partner paid no interest on this loan, received no penalty for this action, and, in fact, was rewarded with a 12 percent rent increase as well as deferment of obligatory payments -- placing the additional burden on the tenants for catching up on the deferred payments.

## 510 WEST BELMONT

This is a 275 unit highrise. The majority of the tenants are elderly and on fixed incomes. The history of this building is replete with examples of some of Chicago's most powerful real estate barons using diverted project funds to pressure HUD into submission, finally resulting in their obtaining a Flexible Subsidy Grant of $898,000.

As early as 1973 a HUD Inspector noted design deficiencies in the windows and roof causing water infiltration in over 50 percent of the apartments. HUD's orders to correct these problems were ignored. Rent increases were granted on the promise that the repairs would be made. Throughout the years various HUD inspections were made of the building. One HUD inspector in particular took it upon himself to cover up the water infiltration problems by blaming them on the tenants failure to close their windows. In July of 1978 tenants participated in a HUD inspection in connection with a proposed rent increase. The inspection report states: "Water leakage around the windows, and from wood moulding above, continue to be one of the major resident concerns and complaints. This certainly is a latent defect due to curtain wall construction design, but it is also aggravated by the lack of proper caulking on the outside window walls."

In August of 1977 an Inspector General audit found the following:

> "Expenses of $21,635.55 were improperly disbursed from project funds for construction costs, legal fees, income tax preparation and bookkeeping services. Also, unauthorized distributions of $35,032 were made to the partners from operating funds in excess of the available surplus cash."

A flurry of letters between HUD and attorneys for the owners took place between September, 1977 and April, 1978. The result was that owners agreed to deposit $24,290 in an escrow account, "...subject to the results of a rent increase application which Seay & Thomas, the managing agent, expects to file in the near future. In particular, the sponsors expect that processing of the 1978 rent increase will generate sufficient income to provide some distribution for 1978 and for future returns on capital as provided for in the Regulatory Agreement" (Appendix C).

Management applied for a 25 percent rent increase in May, 1978. Tenants, determined to force management to make necessary repairs, organized and participated in the HUD Inspection of the building. The inspection report was issued and HUD told management to submit a plan of corrective action including contracts for the work which would cost approximately $280,000. Again, a flurry of irate letters ensued between HUD and the attorney for the owners. In the meantime, the owners stopped paying the mortgage. In September of 1978, $53,000 was taken out of the project and put in an account with Dreyfuss Liquid Assets. As the Inspector General noted in a report issued in January, 1979, a total of $106,000 was eventually put in this account. This report also told the owners to pay back to the project improper payments made to attorneys for doing management's job of applying for a rent increase. When the owners replied that they needed attorneys to obtain rent increases, HUD cleared this finding, thereby paving the way for a future of astronomical attorneys' fees that are passed on to tenants in the form of rent increases.

In February of 1979 the attorney for the owners was still denying the need for the $280,000 worth of repair work ordered by HUD. He suddenly changed his tune after apparently making the following deal with HUD: the owners would become current on the mortgage ... in exchange, HUD would allocate to the owners a Flexible Subsidy Grant of $898,000! (Appendix D)

In October of 1979 tenants examined the MIO plan for Flexible Subsidy submitted by the owners to HUD. They found that the owners were passing the cost of obtaining this $898,000 gift on to the tenants. Legal expenses incurred in obtaining the Flexible Subsidy Grant were $25,000. Auditing expenses were $14 000. A full time resident manager to supervise the MIO plan will cost $24,140 in 1980, up from $2,350 in 1977 (Appendix E). In addition, although the Flexible Subsidy Manual requires that the owner put up one-third to one-half of the grant, this owner put up only $20,000 of the total $898,000!

Tenants submitted their comments to HUD and met with the HUD area manager to ask that these costs not be passed on to tenants in the form of a rent increase. In November, 1979, management asked for a rent increase. A ten percent increase was granted which included the cost of the fees incurred in obtaining the Flexible Subsidy grant.

## HIL'CREST APARTMENTS (AURORA)

Hil'crest Apartments is perhaps the most flagrant example of abuse and mismanagement by an owner/manager that goes unpenalized by HUD, even in the case of an assigned mortgage. Hil'crest is a three-building complex. It is roach and rodent-infested. It has entrance doors with no locks, apartments with collapsed ceilings, torn and filthy hallway carpetiing, and more. The owner/manager runs the building like a prison warden, an example of which is turning off the electricity of a young mother for two weeks because her welfare check was late (this has happened to other tenants as well). In addition, tenants have been physically threatened for attempting to organize to fight the abuse.

The mortgage was assigned to HUD in August of 1976. Since its assignment HUD has failed to act on the following abuses: the failure of the owners to submit audited yearly financial statements or monthly accountings; improper salaries and fees totalling more than $65,000, which ended up in the pocket of the owner/manager and his family; HUD's failure to initiate an audit of the project despite its knowledge of abuse and violations of the Regulatory Agreement. The major threat used by HUD was that of suspension or withdrawal of funds from the Reserve for Replacement...the fund used for repairs of the project. HUD's major threat against the owner/agent was therefore precisely that kind of action which penalizes tenants through the deterioration of the quality of their living environment.

In 1974 and 1975, the owner took distributions despite the fact that there was no surplus cash available. HUD requested that this money be returned to the project, and that financial statements for 1974 and 1975 be submitted. On October 13, 1976, when the statements were finally submitted, the amount improperly taken from the project had grown to $65,986 (Appendix F).

On November 10, 1976, despite the fact that not a penny of the demanded $65,986 was returned to the project, HUD approved a rent increase which went into effect on December 1, 1976, without the proper 30-day notice. In 1977, HUD excused the entire debt to the project by a variety of ingenuous methods: first, the management fee was raised from five percent to six percent retroactively; second, in October of 1977, the remainder was wiped clean by HUD in a letter which stated: "The explanation that the $35,228 paid in excess of the management fee was the cost of lease coordinators is acceptable to this office" (Appendix G). The lease coordinator is the wife of the owner/agent.

In response to a demand by FHA Tenants United, a "limited review" of the project was done by the Regional Inspector General for audit. The review recommended that $4,779 in excess fees be returned as well as the imporper distributions totalling $2,080. The Inspector General also stated that the rent increase requested in January, 1979 was justified, since it was based on "the certified audit report for the year ending December 31, 1978" (Appendix H).

FHA Tenants United requested the assistance of CPA's for the Public Interest in addressing a proposed rent increase and other financial matters. The most shocking finding by CPA's for the Public Interest was the glaring inaccuracy of the Inspector General's report. The project audits for the years 1976, 1977 and 1978 were not certified because the owners' CPA's were unable to express an opinion (Appendix I). In a November 26, 1979 letter FHA Tenants United reminded the HUD area office that approval of a rent increase based on an uncertified audit would be a clear violation of HUD Regulations (Appendix J). We are appalled at what appears to be collusion between HUD, the owners and now the Inspector General's office to cover up the abuse of mismanagement taking place at Hillcrest.

Salaries in excess of what are allowed in the management agreement were still being taken by the owner and his family throughout 1979 including $208 per week as a janitor salary for the owner, $108 for a lease coordinator and social coordinator (also for family members). These salaries were being taken (and still appear to be taken) despite previous HUD sanctions against them.

The history of collusion of HUD officials and the owner in covering up the financial mismanagement continues to the present. As late as October 4, 1978 HUD was still asking for a re-instatemet plan, and a rent increase is presently being considered by HUD despite the failure of the owners' CPA's to certify his audits.

### 840 WEST SUNNYSIDE

This building is a 125 unit highrise. It has severe structural and maintenance problems. When it rains extensive water infiltration occurs. According to an independent architetct who inspected

Sunnyside at the request of the tenant organization. "After water saturates an approximate 8' X 8' carpet, it then streams to and under the partition to the kitchen. After puddling in the kitchen it streams to and under the partition to a bedroom. This is all evidenced by defacement of baseboard heating outlets, floor tile lifting up, tile base pulling away at puddling locations, and/or at partitions." One tenant reports having entered a room in her apartment during a rain storm to see her childen's shoes floating. In addition, this building also suffers from roach and rodent infestation, an inadequate heat distribution system, and badly maintained public areas.

The tenant organization has documented many instances of financial mismanagement and violation of HUD regulations. A few examples are: advertising expenses for other buildings paid out of project accounts (Appendix K). In 1977 management claimed to have spent $53.11 on paint and $8,819 to apply it in a building where tenants complain that little or no decorating is done. At the request of tenants the Inspector General also caught the owner/manager repeatedly breaking leases and forcing tenants to pay higher rent in the middle of a lease. On one occasion when the Inspector General was investigating this issue, again at the request of the tenants, the owner/manager claimed to have "lost" most of the original leases and the Inspector General accepted this excuse.

In January of 1979 tenants and their attorney charged that the rent increase approved by HUD in September, 1978 was based on a false statement submitted by the manager and that there may have been a conspiracy between the agent and HUD loan specialist to grant a rent increase. Although the Inspector General for Investigation stated in his report that, "The date appears to have been altered", (on the document in question) the U.S. Attorney declined to prosecute.

Tenants continued to protest and demonstrate against the conditions at 840 Sunnyside, eventually forcing the owner to resign as managing agent and hire another company. Although conditions are improving at the building it is not yet clear if the major problems will be resolved.

STONY ISLAND TERRACE APARTMENTS

This building is a 240 unit highrise on the south side. Mismanagement and cost misestimates resulted in the property operating at a loss from the very first year of operation. The severe mismanagement finally resulted in default and the assignment of the mortgage to HUD in 1972, three years after the building opened. Since 1972 HUD has threatened foreclosure because of the absence of a long-term reinstatement plan. In September, 1978 the managing agent applied for a rent increase and included the following reason: "An increased amount of rental income is required to be paid on the mortgage now in default" (Appendix L). This action is contrary to HUD Regulations which require that only legitimate operating expenses be used in calculating a rent increase and not delinquent mortgage payments. Management pays large legal expenses (from the project) for their lawyer to handle voluminous correspondence with HUD over the defaulted mortgage rather than develop a satisfactory reinstatement plan. In addition project funds have been put in escrow by the owners, with their release conditional on further deferments of payment on mortgage and to the Reserve for Replacements fund.

The building has severe maintenance problems. All elevators in this 26 story building were inoperable for the month of August, 1979, leaving its elderly residents stranded. Only one elevator was working between September and December. The building has severe roach infestation, leaking windows, and plumbing problems. The incinerators constantly fill the halls with smoke. Janitors charge fees to tenants for common maintenance.

An overcharge to tenants (in rents) occurred after HUD approved a rent increase in May of 1976. Not until the supporting evidence for a further rent increase (September, 1978) was submitted to HUD did HUD discover the overcharge (Appendix M). Although HUD told owners to roll the rents back, this was never done. Instead HUD approved a rent increase in November, 1978 and thereby covered up the overcharge.

## 533 WEST BARRY

This building is a 160 unit highrise. The majority of its tenants are elderly. On November 26, 1975 HUD notified the owners that they were in violation of the Regulatory Agreement in that they charged rent in excess of the amount approved by HUD. The owners were ordered by HUD to lower rent as expenses had decreased, to terminate the managing agent, and told that if these actions were not taken, HUD would declare a regulatory default.

Neither of the actions were taken. Instead, HUD officials met with the owner/managers. These parties agreed that rather than a rent rollback and termination of the managing agent, there would be a rent increase and the managing agent could stay on!

In early 1977 they asked for another rent increase. Tenants subsequently found out about the overcharge and began having meetings with HUD officials demanding a rent rollback and repayment of the overcharged rent. As a result of continued meetings, protests and demonstrations, HUD wrote to the Inspector General on April 18, 1977 and stated,

> "It would appear that the project rents were increased based on possible subterfuge. Additionally, the unapproved rental levels, those in effect from 1974 through April of 1976, appear to have been effected for the purpose of providing distributions to the owners."

HUD states in the same letter, "One item used for this rental increase was a contract for security services with Burns Detective Agency for an amount approximating $20,000. A review of the 1976 financial report indicates that this contract was not entered into." (Appendix N). This letter asks the Inspector General for an audit. The Inspector General's subsequent audit reported that the total overcharge to past and present tenants totalled $42,722. Most of this money was paid back to tenants in January and February of 1978, after months of pressure from the tenant council.

The security patrol that was allegedly started at 533 Barry in July, 1976 appears to have started no sooner than November, 1977. However, $16,000 prior to November, 1977 was paid to so-called employees. In addition, this managing agent made payments totalling $17,300 to two other HUD projects that it owns and manages for "loans" and "exchanges" from the project funds of 533 Barry. Both of the other buildings (4640 North Sheridan and Arbor Trails) have been in and out of serious financial trouble for years. In addition, 533 West Barry project funds were used to pay other questionable expenses such as:

- $25 for a political contribution,
- $100 for membership in the National Hotel Register,
- $60 for Apartment Building Owners of Chicago "dues", and
- $750 for an Attorney Placement fee.

Tenants also discovered that management received interest totalling $38.92 on approximately $130,000 in project assets.

The tenant council was adamant in demanding an investigation into the non-existant security patrol costs which seem to have surfaced in the monthly disbursements a few months prior to any request for a rent increase. The Inspector General did only an incomplete investigation which failed to turn up anything conclusive.

533 Barry had some persistent maintenance problems such as roach infestation, water infiltration and heat distribution problems. The tenant council in the building has been active for almost three years in pressuring management to improve the maintenance problems and in scrutinizing the financial documents. As a result the building is now very well maintained. It should be noted that the new roof, and the tuckpointing were accomplished by a company owned by the General Partner. The rents are fairly reasonable and there is a waiting list. Legal fees are still very high (this building has almost no evictions) in spite of the tenant council's constant demands on HUD to have management curtail these expenses. The tenant council has found documents that state that the reason for some of these high fees "is because of FHA-TU" (Tenants United). We believe that if the owner wants to hire attorneys to fight the tenant council they should pay the fees themselves rather than pay the attorneys from project expenses, and therefore, tenants' rents.

As a result of the continuous scruitny on the part of the tenant organization, 533 Barry is proof that well-maintained moderate priced housing can, indeed, be provided to tenants and be profitable to owners as well.

## QUESTIONABLE BUSINESS PRACTICES AND EXPENSES

In a number of instances, we have found improper payments from project expenses, unreported income or imprudent business practices.

At Vistra Gardens the project paid $10,993 for a deposit to the gas company because the owner/manager developed bad credit at the same building. The manager's refusal to repair a huge leak in the ceiling of a commercial space being rented as a day-care facility forced the day care center to move. This resulted in the project losing thousands of dollars of project income.

In a number of buildings (including Vistra Gardens, 4640 North Sheridan, and 810 West Grace) tenants are routinely charged for such maintenance repairs as replacement of toilets, floor tiles, window shades, window screens, door locks, etc. Yet, in many cases the income from these charges does not appear on the statement of profit and loss to offset the repair expense.

Some examples of questionable expenses paid from project accounts are:

| | | |
|---|---|---|
| . 833 West Buena | $ 25.00 - | Contribution to Citizens for Chris Cohen |
| . 4640 North Sheridan | $105.00 - | Reimbursement for ticket |
| . 533 West Barry | $862.01 - | Office furniture (this building has no office!) |
| . 533 West Barry | $332.44 - | Office furniture |
| . 533 W. Barry | $400.00 - | Christmas bonus fund |
| . 840 West Sunnyside | $ 18.00 - | Advertising for three buildings including 840 W. Sunnyside |
| . 533 West Barry | $150.00 - | Registration for a seminar |

At 533 West Barry and 4640 North Sheridan (both have the same manager) during the first nine months of 1976, management paid close to $7,000 to a relative of the owner/manager who was also the building manager for "decorating" apartments and "security". His son received an additional $3,700. Tenants question whether this amount of decorating was ever done nor have they ever seen the manager perform as a security guard. These payments were in addition to the regular salary this relative received for his duties as a Building Manager. Although the financial practices at 533 West Barry have improved under the tenant council's watchful eye, we cannot say the same for 4640 North Sheridan.

## 4640 NORTH SHERIDAN

This building is a 230 unit highrise. It is managed by the same agent that manages 533 West Barry (the wife of a beneficiary of both buildings).

On January 10, 1974 HUD sent a letter to the agent asking for an explanation of why rents were being charged above the HUD approved levels (Appendix O). Although a flurry of letters passed between the agent and HUD in the ensuing months, the rent overcharge was never halted, excess rental charges were never paid back to the tenants, and no penalty was ever levied against the owners. On June 8, 1978 an attorney for the tenants re-opened the issue and demanded that HUD conduct an audit of the accounts at 4640 North Sheridan and ensure that these sums (totalling approximately $120,000) be refunded to the tenants. HUD attempted to examine the project records and was told by management that they were "lost". HUD evidently accepted this answer and the money was never refunded to tenants.

## [illegible]12 WEST BUENA

This building is a 210 unit highrise. Persistent problems in this building have been roach infestation, water infiltration, poor heat distribution and poor security. However, with the constant vigilance of the tenant council this racially mixed building has become well maintained.

In February of 1979 manaement applied for a rent increase. The letter which tenants wrote to HUD questioning certain expenses was not answered sufficiently by the Manager. At a meeting requested by FHA Tenants United between HUD, the Manager and tenants, the Rental Computation Form (prepared by HUD based on the owners' figures) was compared item-by-item with a form prepared by tenants based on the same figures. A $16,000 discrepancy was shown on HUD's form, in the category of janitors' salaries, an overcharge which HUD had accepted without question. When this was pointed out by tenants, HUD had no choice but to cut the proposed rent increase almost in half (Appendix P).

A repercussion of this meeting is that HUD now adamantly refuses to allow tenants to view the Rental Computation Form before the rent increase is approved or to allow tenants to receive answers to their questions regarding the validity of certain expenses. HUD actually refuses to bring the completed Rental Computation Form into these meetings between tenants, the owners and HUD.

The owner of this building applied for a Flexible Subsidy Grant in order to install storm windows to cut high heating bills, and stabilize rent. We believe that the owners' failure to secure a Flexible Subsidy Grant is in large part due to his good maintenance record and disinclination to resort to default as a tactic to pressure HUD.

## REAL ESTATE TAX

HUD's inability or refusal to take simple action in providing the tax assessor with specific data has resulted in tenants being forced to pay substantially higher rents than necessary. This lack of action has opened the way for fraud as well. In a September 27, 1977 report the General Accounting Office states that HUD has been generally unresponsive to real estate tax problems and that "payment of unnecessarily high taxes results in increased rents for project tenants and can adversely affect project viability". This report points out the serious problems which have occurred as a result of this negligence.

Currently the Cook County Assessors Office classifies subsidized buildings as normal commercial properties unless it is notified that these buildings are subsidized. If notified, the assessor routinely reduces the taxes.

FHA Tenants United had attempted to solve the problem of relying on incompetent management or HUD to notify the assessor by asking a State Senator to initiate legislation to secure initially correct assessments. When the legislation was in committee the Cook County Assessors Office asked us to participate in a meeting. The Deputy Assessor assured us that notification was all that was necessary to insure a low tax assessment. The Assessor further pointed out that this procedure did not require a formal tax protest and that it need not be initiated by an attorney or landlord.

Owners and managers have attempted to get rent increases on the basis of incorrect assessments, have paid enormous legal fees for a simple letter to the assessor, or simply neglected to notify the assessor and paid too much tax. On numerous occasions FHA Tenants United has asked HUD to provide necessary data to the assessor and disallow legal expense s which inflate rent increases. The fees managers paid attorneys for this "service" vary greatly. At 810 West Grace the figure was $21,446 in 1977; at 820 West Belle Plaine the figure was over $20,000 in 1977; at 833 West Buena it was $28,952 in 1976, at 510 West Belmont it was $59,201 in 1972, at 4850 North Clarendon it was approximately $500 in 1977; and at 840 West Sunnyside it was approximately $6,000 in 1978 (Appendix Q). Because HUD has failed to provide the data to the assessor and has failed to establish reasonable guidelines for controllable expenses, tenants again are paying the price.

## CONTROLLABLE EXPENSES

We believe that many of the costs that are driving up the rents in these buidlings are controllable. Constanlty rising rents create havoc in these buildings through heavy turnover, bad debt collection, the loss of income due to move-out/move-in time, and additional re-decorating expenses. Also, as rents rise a higher vacancy rate usually occurs, which merely exacerbates the situation. Some basic expenses such as water vary greatly from building-to-building depending on a number of factors. If the maintenance staff is unwilling or unable to make repairs on constantly running faucets, the water bill ( and heating bill) will be higher than need be. In one building a manager had the water bill for a commercial laundrymat on the same meter as the tenants' use so that the tenants were paying the water bill for the commercial laundry.

On the following page is a chart which shows the variations in per unit, per year costs in six buildings in 1978, revealing significant differences.

In each area of the country a reasonable cost range for controllable expenses must be developed. If owners or managers do not stay within that range, the reason for failure to do so should be determined, and action taken to force them to do so.

PER APARTMENT, PER YEAR EXPENSES IN 1978

| | STONY ISLAND TERRACE | 810 GRACE | 533 BARRY | 510 BELMONT | 4550 CLARENDON | 833 BUENA | +/- RANGE |
|---|---|---|---|---|---|---|---|
| Office Expense | - | $ 10.66 | $ 2.19 | $ 9.78 | $ 8.79 | $ 34.43 | $ 32.24 |
| Management Fee | $139.21 | 143.37 | 142.21 | 91.42 | 133.47 | 102.21 | 51.95 |
| Legal Expense | 42.10 | 2.22 | 66.13 | 90.77 | 8.70 | 45.73 | 88.55 |
| Auditing Expense | | 20.14 | 7.64 | 30.14 | 5.40 | | 24.74 |
| Electricity | 123.38 | 103.06 | 87.26 | 92.33 | 99.12 | 70.40 | 36.12 |
| Water | 54.77 | 98.55 | 34.62 | 39.70 | 44.51 | 28.33 | 70.22 |
| Garbage Removal | 22.40 | 15.24 | 7.03 | 5.36 | 18.65 | 22.78 | 17.42 |
| Gas (Heat and/or Fuel) | 508.75 | 504.76 | 293.69 | 377.70 | 446.15 | 274.08 | 235.67 |
| Real Estate Tax | 414.45 | 481.41 | 341.99 | 329.20 | 333.56 | 405.77 | 152.21 |
| Insurance | 90.57 | 65.14 | 77.16 | 63.10 | 126.72 | 30.98 | 95.74 |

## SUMMARY

Throughout the country there is a severe crisis in the availability of rental housing affordable to low and moderate income families. In some areas of Chicago, the only moderate income units that exist are HUD subsidized buildigs. They must be preserved and their low and moderate income character maintained.

We believe that HUD has failed to protect the interest of tenants in these buildings, not because of bungling or incompetence, but because HUD's primary interest is in protecting the Insurance Fund. In addition, the mortgage bankers and real estate developers have taken over the multi-family housing program and subverted the intent of Congress. The National Housing Act was passed by Congress to provide subsidies for low and moderate income people. Instead. the bulk of these subsidies are going directly to the developers and bankers who are now making policy for HUD.

The most recent example is the Flexible Subsidy program which was intended by Congress to preserve the low and moderate income character of troubled buildings and to make them more habitable for the people who live in them. Project owners are encouraged to increase costs and operating deficits in order to increase the size of the grant. This strategy also passes on inflated costs to tenants through rent increases as has been documented at 510 West Belmont (Appendix E).

The growing interest at HUD to convert rental units to cooperatives, which further shrinks the housing market, is another example of this subversion. Conversions, as rearrangements of project financing, generate greater profit for morgtage banks and developers and tie up program funds that were meant to increase, rather than decrease, available rental units.

There are, indeed, many HUD Regulations and policies that pay lip service to the need for tenant particpation in these projects. In the final analysis, only through a strong tenant organization with full negotiating power to curtail expenses and the power to fully scrutinize the expenditure of government dollars, will the financiers' strangiehold on HUD be broken. It was for tenants that Congress passed these programs. It is time to recognize that tenants alone can safeguard them.

## RECOMMENDATIONS:

1. An immediate investigation of the cooperative conversion at 810 West Grace for conflict of interest, no competitive bidding and possible fraud should begin. The conversion should be stopped immediately.

2. A GAO investigation and audit should be initiated to scrutinize the financial dealings of the Chicago Area Office of HUD.

3. A freeze on rents is necessary to insure that tenants may assist in the development of guidelines for controllable expenses. Tenants no longer can afford to bear the financial burden of HUD and landlord mismanagement.

4. In order to help create tenant stability, reduce vacancy rates, and protect tenants from more than one rent increase per year, one-year leases should be instituted as HUD policy.

5. The Flexible Subsidy program should receive greater funding. Safeguards should be implemented to prevent costs from rising or passed on to tenants as a result of Flexible Subsidy.

6. All considered conversions, changes of ownership, prepayment of the mortgage, or other major financial decisions concerning any project should be subject to approval by tenants.

7. No cooperative conversion should be contemplated that increases the monthly housing expenses of tenants over their present levels.

8. The Section 8 program should be expanded to increase the direct subsidies to tenants who are eligible. Section 8 subsidies should not be reserved to bail out landlords who mismanage their buildings.

9. Congress should allocate funding for a National Tenant Organization on the model of FHA Tenants United. This organization must have negotiating power, in order to protect the interest of those people most affected by HUD and landlord abuse.

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## LETTER FROM VERNON A. WASHINGTON, CHIEF, LOAN MANAGEMENT BRANCH

[illegible]
[illegible]
[illegible] Street
[illegible], Illinois [illegible]

Gentlemen:

Subject: Project No. 071-[illegible]
[illegible]
Chicago, Illinois

We have reviewed the certified financial report covering the operation of the captioned project for the year ended December 31, 1977. That report indicates [illegible] distribution [illegible] of 1977 to which they were entitled.

The [illegible] made distributions of $[illegible] during 1977 yet the accumulated computation of surplus cash shows no cash available for distribution. Instead a negative amount of $[illegible]. Therefore, ownership is responsible for the return of $[illegible] to the project. Documentary evidence of this refund to the project bank account must be submitted to this office not later than 30 days from the date of this letter.

Sincerely,

Vernon A. Washington
Chief
Loan Management Branch

## AUDIT REPORT, OFFICE OF INSPECTOR GENERAL

Issue Date
October 28, 1977
Audit Case Number
CH-93-1

TO: Ron Gatton, Regional Administrator, Region V
Director, Chicago Area Office

Lee M. Stevens

FROM: Lee M. Stevens, Regional Inspector General for Audit
Region V

SUBJECT: Lakeview Towers Apartments
Chicago, Illinois
Project No. 071-55109
Multifamily Mortgage Insurance Program - Section 221(d)(3)

### INTRODUCTION

We have examined the books and records of Lakeview Towers Apartments (Mortgagor) for the period January 1 to July 31, 1977. In addition, we reviewed project operating results for 1976 in connection with the rent increase which was approved by HUD June 29, 1977.

The purpose of our examination was to determine whether: (1) the Mortgagor's procedures for accounting for project receipts and disbursements were adequate; (2) all project resources were fully accounted for and used only for intended purposes; (3) tenant security deposits were properly identified and separately funded in trust accounts; (4) the Management Agent's system and procedures were in compliance with HUD requirements; and (5) the recent rent increase was justified. The examination included such other tests of the accounting records and auditing procedures as we considered necessary.

### SUMMARY

The project disbursed $125,000 to a General Partner during the period January 1 to July 31, 1977. The disbursements were classified as loans. At July 31, 1977, the amount was reduced to $50,000 and was secured by a promissory note dated June 14, 1977. The loans are contrary to the terms of the Regulatory Agreement.

The project disbursed $1,125 to the Management Agent for preparing monthly accounting reports. However, the Management Agreement stipulates that the Agent will submit monthly accounting reports as a specific duty covered by the management fee.

The project had two non-revenue producing apartments which were not authorized by HUD; one unit was assigned to the Assistant Project Manager and the other was used as a model apartment.

Project operating and tenants' security deposit accounts were established in the name of Clarendon Associates, Partnership, rather than in the name of the project.

Our review of the Tenant Group's allegations relating to maintenance and operating expenses and rent increase computations are discussed in the General Comments' section of this report.

The findings were discussed with the Mortgagor's representatives on October 13, 1977. Their comments are included in the appropriate findings in this report.

We recommend that the Area Director instruct the Mortgagor to reimburse the project $50,000 for the outstanding loan, and $1,125 for the excess management fees. The Area Director should also determine the propriety of the use of rent-free apartments, and instruct the Mortgagor to change the bank account titles to comply with HUD requirements.

## FOLLOW-UP ON PRIOR AUDITS

This is the initial audit of the project.

* * * *

Within 30 days please furnish this office, for each deficiency, finding, and/or recommendation cited in the report, comments on: (1) the clearance action taken; (2) the proposed clearance action and the date to be completed; or (3) why action is not considered necessary. Follow-up reports must be submitted to this office at the prescribed time intervals specified in Handbook 2000.5. Also, please furnish this office with copies of any correspondence pertaining to this report.

## BACKGROUND

The Mortgagor is Clarendon Associates, an Illinois limited partnership. The partners are:

| General Partners | Percent of Ownership |
|---|---|
| Draper & Kramer, Inc. | 12.31% |
| Ferd Kramer | 3.65 |
| Murray Wolbach, Jr. | 0.73 |
| **Limited Partners** | |
| Brody Associates | 7.31 |
| Draper & Kramer, Inc. | 7.31 |
| Sonnenschein Clarendon Associates | 7.31 |
| Paul Fromm and Erika Fromm (as joint tenants with right of survivorship) | 7.31 |
| Kenneth Newberger | 7.31 |
| Andrew K. Block | 7.31 |
| Ella B. Stein (as trustee of the Ella B. Stein Trust dated July 1, 1923) | 7.31 |
| Louis P. Fiedler | 7.31 |
| John D. Gray | 3.65 |
| Joseph L. Block | 7.31 |
| Joseph Regenstein | 3.65 |
| Robert Hartman | 3.65 |
| Philip D. Block, Jr. | 3.65 |
| A. J. Gaines | 2.92 |
| Total | 100.00% |

The project consists of 500 units in twin 26-story reinforced concrete towers located at 4550 North Clarendon Avenue, Chicago, Illinois. It has 290 parking spaces and 4,600 square feet of commercial space, a community room and a rental office. The commercial space is leased to a grocery store and a day-care center.

The Management Agent is Draper & Kramer, Inc., one of the General Partners.

On June 8, 1977, HUD approved the deferment of deposits of $3,039.60 to the Reserve for Replacements for the period May 1, 1977 to April 30, 1978. On August 29, 1977, HUD approved deferment of principal payment for the period May 1, 1977 through April 30, 1978.

On May 17, 1977, the owners applied for a rent increase. It was approved June 29, 1977, for a gross monthly rental of $103,650, representing a 12-percent increase.

**Other Pertinent Data**

Original mortgage amount - $8,445,000
Date of final endorsement - January 13, 1971
Number of vacancies at July 31, 1977 - 15

The project mortgage was current as of July 1977. The Mortgagee is the Government National Mortgage Association.

The books and records are located at the office of the Management Agent, Draper and Kramer, Inc., 30 West Monroe Street, Chicago, and at the project rental office.

## INTERNAL CONTROL

The internal control over the receipt and disbursement of funds was adequate.

## FINDINGS AND RECOMMENDATIONS

### Finding 1 - Unauthorized Loans to General Partner

During the period February 14 through July 31, 1977, project funds ranging from $125,000 to $50,000 were disbursed to a General Partner for short-term loans. These transactions were not approved by HUD.

On February 14, 1977, the project disbursed $125,000 to the General Partner. The loan was repaid in full on May 12, 1977. However, on June 14, 1977, an additional $50,000 was disbursed to the General Partner. This amount was shown on project records as a note receivable at July 31, 1977. The loan is secured by a demand promissory note with a 6 3/4-percent annual interest rate.

Paragraph 9(g) of the Regulatory Agreement requires that project funds be deposited in a bank whose deposits are insured by the FDIC. Any owner receiving funds of the project other than by such distribution of surplus cash shall immediately deposit such funds in the project bank account. Any other use of project funds requires written approval of the Secretary.

Depositing project funds in a bank insured by FDIC provides greater protection than a secured note receivable from an identity of interest management agent.

On May 20, 1971, Clarendon Associates authorized the Management Agent/General Partner to borrow excess funds from the project. The Management Agent's representative advised that this arrangement allows the project to earn a higher interest rate on excess funds than are available for short periods.

In view of the above unauthorized loans and the outstanding loan of $50,000, we question the propriety of the deferment of principal payment for the period May 1, 1977 through April 30, 1978.

### Recommendation

We recommend that the Area Director require the Mortgagor to reimburse the project account for the current amount of the note receivable and cease making such loans. We also recommend the Area Director reevaluate the deferment of principal payment to determine if it is still in order.

## LETTERS FROM PAUL E. FREEHLING, CHICAGO, ILL.

April 7, 1978

Mr. Elmer C. Binford
Area Director
U.S. Department of Housing and
Urban Development
One North Dearborn Street
Chicago, Illinois 60602

Re: Project No. 071-55117 LDT
Belmont Harbor Towers
Chicago, Illinois

Dear Mr. Binford:

On behalf of Tom Philipsborn, Tom Teel, Gary Landau, and myself, may I say how much we enjoyed meeting you yesterday and how much we appreciate your cooperation.

Enclosed please find a copy of a deposit slip, evidencing the sponsors' compliance with the agreement reached at our meeting, by depositing $24,290.55 in an account at the Continental Bank entitled "Belmont Tower Apartments - Special Acocunt". The $24,290.55 is the sum of the only open audit findings, the $13,735, $8,055.55, and $2,500 items referred to in various correspondence such as my March 21, 1978 letter to you.

This deposit has been made, and will remain without withdrawals, subject to the following terms and conditions:

1. The sponsors reserve the right at any time to substitute for this deposit a letter of credit issued by the Continental Bank in the same amount, and on the same terms and conditions, as the deposit. If such substitution is made, HUD will be notified promptly.

2. Consideration will be given by HUD to documentation to be produced by the sponsors relating to the Crane Construction item, $8,055.55. The sponsors believe that this documentation will be persuasive in demonstrating to HUD's satisfaction that the $8,055.55 was a normal and proper project expense.

3. Consideration will be given by HUD to the question of whether the sponsors may distribute sums restored which in the aggregate exceed $13,735, the agreed-upon amount of distributions in excess of surplus cash.

4. This deposit is being made subject to the results of a rent increase application which Seay & Thomas, the management agent, expects to file in the near future. In particular, the sponsors expect that processing of the 1978 rent increase will generate sufficient income to provide some distribution for 1978 and for future returns on capital as provided for in the Regulatory Agreement.

Again, thank you for your cooperation.

Very truly yours,

Paul E. Freehling

April 12, 1979

Mr. Elmer Binford
Department of Housing
and Urban Development
One North Dearborn Street
Chicago, Illinois 60602

Re: 510 Belmont

Dear Mr. Binford:

Enclosed herewith is a copy of a letter we are delivering to Mr. C.C. Parker of FNMA today, together with checks totalling $57,353.60 (copies of the checks are attached hereto). This sum was paid to FNMA, at HUD's insistence, in order to bring the mortgage current. We understand that, as a result of liquidating the entire delinquency, GNMA will revoke its election to assign the mortgage to HUD, thus assuring the projects' eligibility for flexible subsidy funds.

As HUD is well aware, the decision to bring the mortgage current was made only because of pressure from HUD. The potentially catastrophic consequences of totally depleting the building's liquid assets in this manner cannot be overstated. For example,

1. The building no longer has any funds with which to pay for what HUD calls "repairs" and "deferred maintenance". HUD has demanded that these "repairs" be made as the price for approving the rent increase applied for 12 months ago which HUD still has neither approved nor disapproved. Now, there is no money to pay for the "repairs".

2. The entire replacement reserve has been exhausted, thereby leaving no sums whatsoever to use if any equipment or fixtures need to be replaced. The vulnerability of the building is obvious.

3. Almost every cent in the building's bank account has been consumed. If any unanticipated repairs or services should become necessary, there will be absolutely no money to pay for them.

The owners have again, as they have on so many occasions in the past, complied with HUD's directive (this time, to cure the mortgage default) despite the owners' conviction that prudence dictates refusing to do so. The only reason the owners have complied on this occasion is that HUD has given assurances that, in exchange, 510 Belmont will remain in the highest possible position on the list of potential flexible subsidy award recipients.

It hardly seems necessary to recount again the events which led to this building's desperate financial condition. As you know, the owners have done their part to make the building one of the finest of its type, and to keep it that way. They invested more than $500,000 of their own money at the outset to cause room sizes and building amenities to exceed HUD's minimum requirements. The location is unbeatable, and the vacancy factor over the years has been virtually non-existent. Nevertheless, there has been no return on the investors' equity for years.

As you also know, however, HUD's conduct has brought the building to the brink of insolvency. For example, solely because of HUD's delays, it took until May 1977 to effect the rent increase applied for in September 1976; the income lost as a result cannot be regained. The only reason the present windows, about whose performance HUD complains so vigorously, were installed was that HUD insisted on it over the owners' objections. The income which has been lost because HUD has not yet (12 months after the application was submitted) allowed the rent increase applied for last Spring cannot be regained.

Time is running out. Unless HUD takes positive steps forthwith to save this building, it will be too late to save it.

Very truly yours,

Paul E. Froehling

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### LETTER FROM SALLY MESSNER, 510 W. BELMONT TENANT COUNCIL

October 22, 1979

Mr. Elmer Binford
Area Manager
Chicago Area Office
U.S. Department of Housing
and Urban Development
One North Dearborn
Chicago, Illinois, 60602

Dear Mr. Binford:

These comments are prepared by the 510 W. Belmont Tenant Council, a member of FHA Tenants United, in response to the owners' application for a Flexible Subsidy Grant of $898,000. At this time, it is not our intent to analyze each and every item in the MIO Plan submitted by the landlord of 510 W. Belmont. Though we feel that some of these items are either padded or clearly unnecessary, we are concerned at this time with the eventual burden to be put upon the tenants as a result of this Flexible Subsidy Grant, if it is approved as is.

It appears that the present means of implementing this plan is in contradiction with the law passed by Congress, which is to aid in maintaining the low and moderate income character of the building. Specifically, it encourages the landlord to operate at a deficit and to accumulate unpaid bills in order to have them paid by the Flexible Subsidy Grant. It encourages the landlord to increase operating costs during the years of the Flexible Subsidy Grant. In effect, this eliminates the possibility of surplus funds, to which under the program, must be returned to HUD. If a seven year old child is given $5. to spend and told that anything not spent must be returned, he will certainly spend every last penny.

The Flexible Subsidy Program invites the landlord to incur many additional operating expenses which will eventually be absorbed by the tenant. Since the program was not designed to relieve the suffering of the already overburdened low and middle income tenant, it should at least guarantee that no rent increase will be afforded the landlord during the contract period.

Some of the operating expenses that clearly will increase as a result of this MIO Plan are the following:

1. Security: Management plans to put in a $51,000. security system, which includes a television monitoring system. It is quite obvious that it will be necessary to have someone watching these monitors. It is not a job of the janitorial staff to maintain a closed circuit vigil, therefore, the costs of additional security will lie with the tenants. This is unacceptable.
2. Heating system: Management intends to overhaul and adjust the heating system to comply with the energy conservation plan. This should reduce operating costs, but in fact, management projects that gas expenses will increase 17% in 1979, and 9% in 1980 - again, to fall in the lap of the tenants.

Further costs that will be passed on to the tenants are those incurred in obtaining a Flexible Subsidy grant. These include the following:

1. Legal expenses: In 1979, projected legal expenses are $25,000. In 1980, they will be $12,000., a figure which is still excessive.

2. Auditing expenses: In 1977 auditing expenses were $4,415., in 1978 they were $8,290., in 1979 they are $14,000., in 1980 they are projected to be $8,600. These expenses are out of line and unacceptable.

3. Telephone: In 1977 the cost was $292., in 1980 the cost is projected to be $865.

4. Service charges: Late charges in 1980 are projected to be $10,220. With payment of these charges from the Flexible Subsidy grant, these charges defy reason. Furthermore, if the landlord wants to incur late charges in order to obtain Flexible Subsidy funds to cover operating deficits, he should pay them, not the tenants.

5. Resident manager salaries: In 1977 resident manager salaries were $2,350., in 1980 they are projected to be $24,140. This is not in accordance with the management agreement submitted in connection with the application for Flexible Subsidy, which states (page 2, number 3): "The owner agrees to pay Agent as its full and entire compensation hereunder an amount equal to four percent (4%) of the revenues...From said compensation, Agent shall pay the salary of a resident manager, salaries of all clerical employees employed by it, charges for all bookkeeping services in connection with the preparation and submission of operating reports, in addition to the compensation for the services of Agent's supervisory personnel involved in the management of the Property." If intensive supervision is necessary to implement the MIO, it is not the responsibility of tenants to pay for it. Furthermore, it is not a justification to violate the terms of the Management Agreement.

6. Routine repairs and Decorating: Management projects an expense of $38,608.for routine repairs in 1980 and $38,600.for decorating in 1980. Both of these expenses are being paid for by Flexible Subsidy funds! This is not a cost to be absorbed by the tenant or used as an operating cost for future rent increases.

The total cost of these "operating expenses" which are being incurred in obtaining the Flexible Subsidy grant is $133,033. In addition, management plans to request a 12% rent increase for 1980 in order to offset what is claimed to be a $62,000. deficit as well as ask HUD in its MIO plan for the same amount to cover the rest of the so-called deficit. If HUD chooses to pay these unjustified costs, that is its concern. However, the tenants must not be the unwitting victims of this policy.

In addition, we call your attention to the following: Exhibit III, Financial Assistance Contract dated October 5, 1979. Management states in this document that "It is expected that the Flexible Subsidy and rent increases granted during subsidy contract year will enable the project to cure delinquent mortgage payments and tax escrows, provide sufficient income to cover ongoing project operations and generate sufficient surplus cash to resume 6% distributions to the partners after 1980". Management is totally incorrect, for the program manual states that the owners may not take distributions for the projected period of the contract, or any year in which money is granted from that contract. Furthermore, the intent of the program is not to guarantee a 6% distribution to owners, but to maintain the low and moderate income character of the building.

The owners of this building are asking for a gift of $898,000., to which they will contribute a mere $20,000. The enormity of this bequest makes it not only infeasible but totally outrageous to subsequently ask tenants for a rent increase. The past behavior of this landlord clearly indicates a refusal to conform to both the intent and the letter of the law. It is incumbent upon HUD to use the Flexible Subsidy Program to force the landlord to improve his performance.

This program has been designed in its present form only to benefit the landlord. In order for it to benefit the tenant as well, it must have a provision prohibiting rent increases for a period of two years after approval of the Flexible Subsidy grant. This will be time enough to see the energy savings and to let costs stabilize. It will also encourage landlords to keep costs down and thereby stabilize rents. As it is presently implemented, it will have the opposite result: it will invite landlords to increase their operating expenses, finally to be taken out of the pockets of the tenant.

Sincerely,
Sally Messner (sr)
Sally Messner
510 W. Belmont Tenant Council

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## LETTERS FROM VERNON A. WASHINGTON, CHIEF, LOAN MANAGEMENT BRANCH

October 13, 1976

5.2 ML (Seils)

Mr. James R. Little
Earl Little and Son, Incorporated
385 West Old Indian Trail
Aurora, Illinois 60506

Dear Mr. Little:

Subject: Project No. 071-44046 LD SHM
Hillcrest Apartments
Aurora, Illinois

The financial statements for 1974 and 1975 have been reviewed.

Withdrawals of $6,847 were made in 1973 and 1974 without benefit of surplus cash. As pointed out in prior letters, the total of $13,694 must be returned to the project and depository evidence provided.

In the 1975 statement, please explain the $7,555 advances to the management agent as shown in the current assets of the balance sheet.

Our files contain a management agreement dated May 4, 1971. There has been no renewal or replacement of this agreement; therefore, the stipulations therein are considered to still be in effect. The agreement indicates a 5% fee from which the Agent shall pay the resident manager, all clerical employees, and charges for bookkeeping services and services in connection with the preparation and submission of operating reports in addition to the compensation for the services of the Agent's supervisory personnel involved in the management of the project.

The following management charges appear on the HUD 92410s.

| | TOTAL CHARGES | 5% OF INCOME | EXCESS OVER 5% |
|---|---|---|---|
| 1972 | $20,860 | $9,001 | $11,859 |
| 1973 | 23,547 | 12,948 | 10,599 |
| 1974 | 22,028 | 12,578 | 9,450 |
| 1975 | 25,532 | 12,703 | 12,829 |
| Totals | $91,967 | $47,230 | $44,737 |

The management agent must return to the project $44,737 in excess fees collected and depository evidence submitted.

Resolution and response to the above will be expected by November 19, 1976.

Sincerely,

Vernon A. Washington
Chief
Loan Management Branch

---

May 5, 1977

James R. Little
Earl Little & Son, Inc.
385 West Old Indian Trail
Aurora, Illinois 60506

Dear Mr. Little:

Subject: Project No. 071-44046 LD SIM
Hil'crest Apartments
Aurora, Illinois

This is in response to your letter of November 15, 1976 which was in answer to ours of October 13, 1976.

This office's approval of the change of the management fee from 5% to 6% is recognized. This change by no means wipes out the excess fees as you claim but does reduce them from $44,737 to $35,278. This latter amount must be returned to the project. Please submit your plan for the expeditious correction of this matter.

The distribution of $13,694 made in the years 1973 and 1974 without benefit of surplus cash must be returned to the project.

Your response by June 1, 1977 would be appreciated.

Sincerely,

Vernon A. Washington
Chief
Loan Management Branch

---

October 4, 1977

James R. Little
ELJR Development Corp.
385 West Old Indian Trail
Aurora, Illinois 60506

cc:
OLM, Attn: R. Swetz
ARA, Attn: D. Bedenfield
Seils

Dear Mr. Little:

Subject: Project No. 071-44046 LD
Hil'Crest Apartments

This is in response to your letter of May 27, 1977.

The explanation that the $35,278 paid in excess of the management was the cost of lease coordinators is acceptable to this office. This matter is closed.

There was no surplus cash in 1973 and 1974, therefore no distributions could be properly made. Since there was no surplus cash the $11,608 contributed by the general partners must have been used to defray expenses toward the operation of the project. It could not then be used again to make distribution to the partners. The improper distributions of $13,694 made in 1973 and 1974 must be returned to the project.

The management agreement in your possession has been honored by this office but it has never been a valid agreement since it was not executed by the mortgagee or HUD. Attached is a copy of our letter of May 5, 1977 requesting a management agreement and plan. Please comply at once.

The 1976 financial statement due March 1, 1977 has not been received as yet. Please submit.

Monthly accountings on the attached forms have not been submitted. These should start at once and continue.

Please submit a plan for bringing the mortgage to complete currency on the forms attached hereto. This plan should include bringing the mortgage current through interest on the front end.

Your complete and satisfactory response to the above item will be expected by November 1, 1977. The absence of this compliance will allow no further alternative than to recommend foreclosure.

Sincerely,

5.7M:Sells:cas 3-9172 10-4-77

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AUDIT REPORT, OFFICE OF INSPECTOR GENERAL

| | |
|---|---|
| Issue Date<br>July 26, 1979 | |
| Audit Case Number<br>CH 93-124 | |

TO: Ron Gatton, Regional Administrator, Region V
Elmer C. Binford, Area Manager, Chicago Area Office

Lee M. Stevens

FROM: Lee M. Stevens, Regional Inspector General for Audit Region V

SUBJECT: Multifamily Mortgage Insurance Program - Section 236
Hil'Crest Apartments
Aurora, Illinois CH-[illegible]

## INTRODUCTION

We have made a limited review of the files and records of Hil'Crest Apartments (Mortgagor), from 1972 through June 30, 1979. Our audit started on June 18, 1979, and was completed July 10, 1979.

The purpose of our examination was to evaluate the allegations prepared by FHA Tenants United on May 31, 1979. To this extent, we reviewed withdrawals on payments to the partners, management fees taken, yearly financial statements for establishing the propriety of rent increases, tenant accounts and leases to establish the propriety of implementation of rent increases, the handling of all facets of tenant eligibility and rent supplements received, and project vacancies and maintenance.

The findings included in this report are the conclusions of the HUD Office of Audit, based on the auditor's testing of the Mortgagor's operations. The findings are subject to a final review and determination by the Area Manager as to the corrective action needed.

## SUMMARY

The Management Agent paid $4,779 in fees in excess of the amount earned over the 7-year period from 1972 to 1978. Fees paid in excess of earnings depletes project funds for necessary operations and is not proper in accordance with the management contract.

We recommend that the Area Manager require the Agent to return the $4,779 to project funds.

The Mortgagor partners withdrew $2,086 from project funds in 1974, although surplus cash was not available. Withdrawals by partners under such conditions depletes project funds needed for maintenance and debt liability.

We recommend that the Area Manager request the Mortgagor-Partner to return the $2,086 to project funds.

Our review of rent increases, tenant recertifications, rent supplements, vacant units and other general obligations is covered in the General Comments' section of this report.

On July 6, 1979, we held a close-out conference with the Mortgagor at the Management Agent's office. The Mortgagor's response is included in the findings of this report.

## FOLLOW-UP ON PRIOR AUDITS

This is the initial OIG audit of Hil'Crest Apartments.

* * * * *

Within 60 days, please furnish this office, for each recommendation cited in the report, a status report on: (1) the clearance action taken: (2) the proposed clearance action and the date to be completed; or (3) why action is not considered necessary. If the initial status report does not result in the closing of all recommendations, please provide us, within 75 days after the initial report, a final report of corrective actions taken. Also, please furnish us copies of any correspondence or directives issued related to the audit.

## BACKGROUND

At the inception (1972) of the project, it was owned by:

John Page - Limited partner
James Little - General partner
Earl Little - " "
John Matthews - " "

In December 1977, the limited partner and two of the general partners dropped out of the partnership and assigned their interest to the now sole owner, James Little. The project is located at 104 S. Lincoln Avenue, Aurora, Illinois. The complex consists of 134 units in three buildings.

The project was assigned to the Secretary of HUD on August 19, 1976. The original maximum insurable mortgage was $2,183,600.

## INTERNAL CONTROL

The internal controls over receipts and disbursements, eligibilities, certifications and recertifications were adequate.

## FINDINGS AND RECOMMENDATIONS

### Finding 1 - Management Fees Exceed Contract

Over a period of 7 years, management took $4,779 more in fees than stipulated in the management agreement. On May 4, 1972, the Chicago Area Office approved Amendment No. 1 to the Management Agreement, and it stipulated that the fee should be 6 percent of gross collections. The details of the unauthorized withdrawals are as follows:

| Year | Percent | Gross Collections | Earned Fee | Fee Taken in Cash |
|---|---|---|---|---|
| 1972 | 6 | $170,393 | $ 10,224 | $ 8,920 |
| 1973 | 6 | 258,353 | 15,501 | 16,066 |
| 1974 | 6 | 241,185 | 14,471 | 17,411 |
| 1975 | 6 | 247,000 | 14,820 | 18,434* |
| 1976 | 6 | 268,064 | 16,084 | 14,708 |
| 1977 | 6 | 279,272 | 16,756 | 18,243 |
| 1978 | 6 | 292,456 | 17,547 | 16,400 |
| | Total | | 105,403 | $110,182 |
| | Excess | | 4,779 | |
| | | | $110,182 | |

*Includes a $7,555 advance.

Withdrawals of unearned fees depletes funds needed for mortgage indebtedness and maintenance.

The Mortgagor told us the project accountant will review the records and if the result is the same as OIG's, a return of excess fees to the project fund account will be made.

#### Recommendation

We recommend that the Area Manager require the Mortgagor to refund the excess fees to the project account.

### Finding 2 - Net Partners' Withdrawal Not Returned to Project

In 1973 and 1974, the partners withdrew $13,694 as a limited distribution even though surplus cash was not available. The improper withdrawal of funds reduces funds needed for mortgage payments and necessary expenses.

The Area Office wrote six letters from May 1974 to October 4, 1977, requesting the return of these funds to the project. The General Partner replied on October 31, 1977, that the net withdrawal of $2,086 would be returned that year. The partners had returned $11,608 in 1973.

As stated in the Regulatory Agreement, paragraph 6(b), no distributions may be made to the partners unless surplus cash is available and the mortgage is current.

The Mortgagor stated that although the net withdrawal of $2,086 had been forgiven per HUD's letter of January 16, 1978, he is willing to return the above amount if so requested by the Area Office.

Recommendation

We recommend that the Area Manager require the Mortgagor to return the $2,086 to the project bank amount, and furnish HUD with evidence of such action.

## GENERAL COMMENTS

### (1) Rent Increases

FHA Tenants United inquired as to whether the rent increases requested and granted were justified and properly implemented. Our analysis of the rent increase approved as of December 1, 1976, is as follows:

- On the basis of figures for 1975 (audited and certified by a CPA firm) and forecasts to July 1976, the rent increase of $27,540 per year was justified. We computed a loss of $27,819 which could be practically eliminated by the $27,540 increase. However, there would be no provision in the rent increase to cover a 6-percent limited dividend for the partners.

  The rent increase was properly implemented by project management. No tenant was charged the higher rent until his/her lease expired. For example, two tenants whose leases expired on November 30, 1976, were not charged the higher rent until December 1977.

  The rent increase was approved by the Area Office.

Our analysis of the rent increase requested for January 1, 1979, is:

- On the basis of the certified audit report for the year ended December 31, 1978, a rent increase is justified. We computed a loss of $28,258 to which we added principal payments and reserve for replacement payments, creating a shortage of income of $52,776. This does not provide for a 6-percent limited dividend to the partners. The $52,776 figure would call for a rent increase of $4,400 per month, or $33 per unit per month.

The Area Office made a management review of the project on March 19, 1979. Since the Mortgagor's response to the review, which detailed maintenance deficiencies, was unsatisfactory, HUD turned down the rent increase request as of March 28, 1979. However, this does not mean the issue is closed. If the Mortgagor satisfactorily resolves the points in the Area Office's memorandum, the increase will be reconsidered.

### (2) Tenant Eligibility

We randomly selected and reviewed 30 tenant files on eligibility, certifications, recertifications, income verifications, leases and rent computations, and found that these functions were generally implemented properly and adequately. Tenant leases were properly executed, but individual tenant files did not contain evidence that every tenant had received a copy of the lease. The Mortgagor stated that every tenant received a copy of his or her lease.

### (3) Security Deposits

The security deposits were deposited into an interest-bearing account. Interest would only be paid to the tenant upon leaving the complex.

### (4) Vacancy Inspection

We made a general inspection of the project. There were six vacant units, although one was rented that same day. Three of the remaining five units were in rentable condition, and two needed extensive repairs. The woodtile flooring needs to be replaced and the interior of the apartment needs to be repainted. The ceiling in both apartments leaked. One of these apartments has three broken windows. The Mortgagor, however, assured us that he will repair the two apartments, making them habitable. Evidence of considerable work in that direction was noted.

### (5) Financial Statements and Monthly Reports

The financial statements from 1972 to 1978 were all submitted to HUD. The submissions which were late follow:

1974 statements submitted 1½ years late
1975 statements submitted 6 months late
1976 statements submitted 1 2/3 years late
1977 statements submitted 8 months late
1978 statements submitted April 7, 1979 (5 weeks)

Monthly accounting reports were submitted for all months in 1977, 1978 and 1979 (to June).

(6) The President of the project received a weekly salary of $208 which began in August 1976 for janitor services. The President stopped drawing the weekly salary on April 30, 1979. The HUD Area Office considered the President's salary, drawn from project funds, as a distribution to owners which is in violation of the Regulatory Agreement, paragraph 6(e), since the project was not in a surplus cash position, and requested repayment to the project. At the end of our review, repayment had not been made.

best copy available

## LETTER FROM CPA'S FOR THE PUBLIC INTEREST

November 16, 1979

F. H. A. Tenants United
615 Wellington
Chicago, Illinois 60657

Gentlemen:

You have asked us to provide our comments with respect to a requested rental increase for the following project:

Project Number 471-44046 L. D.
Hillcrest Apartments
Aurora, Illinois

Our comments are based on a reading of the documents you have provided to us which are listed below:

1. Correspondence from the files of HUD dated October 13, 1976, May 5, 1977 (2) and October 4, 1977.
2. Copy of the audit report from the Office of Inspector General (Audit Case Number CH 93-124) dated July 26, 1979.
3. Copies of financial statements and reports of certified public accountants on an annual basis for the project beginning with the calendar year ended December 31, 1972 and concluding with the calendar year ending December 31, 1978.

The audit report from the Office of Inspector General discusses the proposed rent increase on Page 6. It indicates that with the exception of physical maintenance deficiences the audit did not find basis for refusing the rent increase or challenging the figures on which it would be based. You have asked us whether our reading of the above scheduled materials leads us to the same conclusion.

The reading of financial statements and selected documents is not a sufficient basis for us to reach a conclusion concerning the propriety of a rate increase and we express no opinion as to the propriety of the rate increase. Nevertheless, our reading of the material gave rise to some questions which you may wish to have resolved by or with HUD prior to the granting of a rental increase described in Page 6 of the Inspector General's audit report. These questions are as follows:

1. The Inspector General's audit report, on Page 6, refers to a "certified audit report" for the year ended December 31, 1978 and uses the results reported therein as the starting point for a computation of rental increase. In fact, the audit report for the year may not be a "certified audit report." On Page 1 of said report (issued by Seidman & Seidman, Certified Public Accountants, as of March 2, 1979) the following statement is made: "As described in the second preceding paragraph, the scope of our work was not sufficient to enable us to express an opinion and because of the possible material effects of the matters discussed in the preceding paragraph, we do not express an opinion on the accompanying financial statement." (emphasis added)

This is a disclaimer of opinion and therefore, may not be considered a "certified audit report." Similar disclaimers were issued for the years of 1976 and 1977. In each instance, the basis for the disclaimer was that the partnership (Hil'crest) "...maintains a substantial portion of its cash from rents and other receipts on hand. The Company's records do not permit the application of adequate alternative procedures regarding *either* the amount of cash on hand or the *receipt* and *disposition* of such funds." (emphasis added) There is nothing in the auditor's report to indicate that they found, in the course of their examination, an impropriety in the area of revenues and expenses; nevertheless, they were unable to give an auditor's opinion because of these matters for the year 1978. You may wish to question whether such financial statements should serve as a basis for calculating a rental increase for the year 1979.

2. The audit report from the Office of the Inspector General indicates on Page 8 that during 1978 (and for periods before and after) "the President of the project received a weekly salary of $208... The HUD Area Office considered the President's salary, drawn from the project funds as a distribution to owners which is in violation of the Regulatory Agreement, paragraph 6 (e), since the project was not in a surplus cash position, and requested repayment to the project." This statement raised several questions. First, the annual reports on financial statements, examined by Seidman & Seidman, for the years in question include a schedule entitled "Compensation of Beneficiaries." The form of the schedule indicates that owners receiving compensation from the partnership should be listed on the schedule. In the years in question, including 1978, the schedules are marked "none." Accordingly, there is a completely opposite conclusion to be drawn from the report of the Inspector General and the report on financial statements. Second, if the Inspector General's report is correct, the expenses for 1978 include charges in excess of $10,000 which are inappropriate. On Page 6 of the report of the Inspector General where a rent increase is discussed, there is no indication as to whether the loss for 1978 has been adjusted to eliminate this expense.

3. HUD correspondence dated October 13, 1976, May 5, 1977 (2), and October 4, 1977, refer, in whole or in part, to excess management fees for the year 1972 through 1975. In the October 4, 1977 correspondence this excess is waived on the strength of an explanation that $35,278 was the cost of lease coordinators. The correspondence further indicates that the excess was calculated by comparing certain of the administrative expenses per the report on financial statements with six percent of revenues which the correspondence indicates is the appropriate management fee.

   For the years of 1976, 1977, and 1978, such administrative expenses continued to exceed six percent of revenues. Whether such excess continues to be acceptable is not ascertainable from the materials submitted to us. The audit report by the Office of the Inspector General is silent on this subject. Based on our calculations for 1978, similar to the calculations made by HUD for the years 1972 through 1975, such excess administrative expenses for 1978 approximated $16,000. It appears that determinations should be made as to (a) whether such expenses are approved or disapproved at present, and (b) whether the audit report of the Office of Inspector General has included these "excess" expenses in its calculation of loss for purposes of considering a rental increase as presented on Page 6 of their report.

CPAs for the Public Interest thanks you for the opportunity of being of service. In concluding, we point out again that the above represents certain observations and questions arising from our reading of selected materials provided to us by you and we express no opinion as to the propriety of the rate increase.

Very truly yours,

CPAs for the Public Interest

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## LETTER FROM FHA TENANTS UNITED

November 26, 1979

Mr. Elmer Binford
Area Manager
Chicago Area Office
U.S. Department of Housing and
  Urban Development
One North Dearborn
Chicago, Illinois, 60602

Dear Mr. Binford:

This letter is in regards to Hil'crest Apartments in Aurora. As you know, the owner/agent of the project recently requested a rent increase.

This project has a long and serious history of mismanagement and violations of both the Regulatory Agreement and HUD Regulations which has been documented by your staff in correspondence with the owner/agent that is available in HUD files. Because of this, FHA Tenants United has sought assistance from various parties to clarify the nature and extent of this mismanagement. On May 31, 1979, members of FHA Tenants United met with Sterling Evans, Regional Inspector General for Investigation and asked for a complete investigation and audit of the project. Instead what we received was a "limited review" issued on July 26, 1979 from Lee M. Stevens, Regional Inspector General for Audit. We were disappointed that this "limited review" of the project was so incomplete. In addition, with regards to the rent increase requested on January 1, 1979, the Inspector General states: "On the basis of the certified audit report for the year ended December 31, 1978, a rent increase is justified." This statement is incorrect. The audit was not certified. As a result of the incomplete and incorrect "review" by the Inspector General, FHA Tenants United requested the assistance of CPAs for the Public Interest to address particular questions regarding the rent increase and other financial matters reviewed by the Inspector General.

Enclosed is a copy of the letter this organization received from CPAs for the Public Interest. We call your attention to page two of this letter. CPA's for the Public Interest indicates that because Seidman and Seidman (the project auditors), said that "we do not express an opinion", that this may not be considered a "certified audit report". FHA Tenants United would like to remind you that approving a rent increase,now or in the future, based on an audit which is not certified, would be a clear violation of HUD Regulations.

Furthermore, CPA's for the Public Interest concurs with FHA Tenants United in raising questions regarding excessive salaries taken from the project by the owners, and regarding excess management fees which continue to be taken by the owners despite previous HUD sanctions against them.

We are continuing in our effort, now that the situation at Hil'crest is clarified, to see to it that the situation is rectified. We ask that you request a complete audit and investigation of Hil'crest Apartments, and that you notify us of the results of this audit and investigation. We expect that the proposed rent increase will be denied in accordance with HUD regulations regarding certified audits. In addition, we expect that upon completion of the audit and investigation all necessary steps will be taken by you to put an end to the abuse and mismanagement which is taking place at Hil'crest Apartments.

Sincerely,

Diann Jackson
Corresponding Secretary

Joan MacDonald
Board Member

Lula Walker
Board Member

FHA Tenants United

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Rotor Building Management Corp.
441 W. Oakdale
Chicago,Ill. 60657

Chicago, Ill. 60602

March 14,1977

To

**THE EDELSON ORGANIZATION**
Publishers' Advertising Representatives
FOREIGN LANGUAGE NEWSPAPERS
127 NORTH DEARBORN STREET

840

Account Number

B-5113 Tearsheet enclosed

| PUBLICATION | SPACE | RATE | AMOUNT |
|---|---|---|---|
| El Informador--March 10,1977 | 3" | $6.00" | ~~$18.00~~ |
| EQUAL OPPORTUNITY APARTMENT RENTING<br>2443 W. Bryn Mawr<br>840 W. Sunnside<br>1016 W. Balmoral | | | 30.00 |

#2653
4/7/77

## NOTICE TO RESIDENTS OF ISLAND TERRACE APARTMENTS OF INTENTION TO FILE AN APPLICATION TO HUD FOR AN INCREASE IN THE MAXIMUM PERMISSIBLE RENTS

August 1, 1978
Date

This is to advise you that 30 days from the date of posting notice above, we plan to file an application for approval of an increase in the maximum permissible rents for Island Terrace Apartments to the United States Department of Housing and Urban Development (HUD). The proposed increase is needed for the following reasons:

1. The Apartments have operated at a loss from the date of first occupancy resulting in a default on the property's HUD insured mortgage and the Assignment of the mortgage to HUD. HUD requires that the property be able to show its ability not to operate at a loss and to make mortgage payments which will cause a reduction of delinquent principal payments equal to or approximating the mortgage requirements.

2. The foregoing requires an increased amount of rental income to be paid on the mortgage now in default.

3. The operation of the building has experienced substantial increases in maintenance expenses, heating fuel, electricity, water, payroll and janitorial and maintenance supplies costs and economists are projecting further inflationary costs increases for 1978-1979 of over 10%.

4. The ownership and management of the building do not desire to cut back in services and maintenance in the building and therefore can meet the increased expenses and requirements only through a rent increase.

The rent increase for which we plan to apply is as follows:

| Bedrooms | Present Rents | Percentage Increase | Proposed Increase | Proposed Rent |
|---|---|---|---|---|
| 1 | 180.56 | 9.1% | 16.44 | $197.00 |
| 2 | 211.88 | 12.8% | 27.12 | 239.00 |
| 3 | 243.19 | 13.5% | 32.81 | 276.00 |

Recommendations are also being made to HUD for approval of a rent credit program for those tenants who may have inadvertantly been charged and paid overcharges since about July, 1976. More information concerning this will be made available in the near future.

Copies of the material that we intend to submit to HUD in support of our application will be available during normal business hours at the building's office for a period of 30 days from the date of posting of this notice for inspection and copying by residents of Island Terrace Apartments, and, if the wish, legal or other representatives acting for them individually or as a group.

During the period of 30 days from the date of this notice, tenants of Island Terrace Apartments may submit written comments on the proposed rental increase to us at the building office. Tenant representatives may assist tenants in preparing those comments. (The inspection and comment period will be extended to give tenants 5 days to inspect and comment on any materials to be submitted in support of the application that are not available to the tenants during the first 25 days of the 30 day period.) These comments will be transmitted to HUD, along with our evaluation of them and our application for an increase. You may also send a copy of your comments directly to HUD at the following address: United States Department of Housing and Urban Development, One North Dearborn Street, Chicago, Illinois 60602, Attention: Director; Housing Management Division. Re: Project No. 071 - 55094; Island Terrace Apartments.

HUD will approve or disapprove the proposed rental increase upon reviewing the application and comments. When HUD advises us in writing of its decision on our application, you will be notified at least 30 days before any allowable increase is put into effect, in accordance with the terms of existing leases.

Albert H. Johnson Realty Company
Management Agents
Island Terrace Apartments

## Letter From Vernon A. Washington, Chief, Loan Management Branch

January 12, 1978

5.2HL(Seils)

Herbert H. Fisher
Suite 1423 - Brunswick Bldg.
69 West Washington Street
Chicago, Illinois 60602

Dear Mr. Fisher:

Subject: Project No. 071-55094 SHM
Island Terrace Apartments

In our letter of May 17, 1976 this office approved a gross monthly rents of $49,598. A review of material to support a recent request for a rent increase, it was found that the rentals were increased to a gross monthly level of $52,200. This action is a violation of Item 4(d)(1) and (2) of the Regulatory Agreement. The violation must be rectified by a return of the rents to the $49,598 monthly level and all overpayments refunded to the tenants or credited to future rents. Please submit a Form HUD 92458, Rental Schedule, showing the rents at this level.

Sincerely,

Vernon A. Washington
Chief
Loan Management Branch

Attachments

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BEST AVAILABLE COPY

It would appear that the project rents were increased based on possible subsidies. Additionally, the unapproved rental levels, those in effect from 1974 through April of 1976 appear to have been effected for the purpose of providing distributions to owners.

Reports from the tenant's organization at the project also indicate other discrepancies in project operation.

Please have as expeditious an audit as possible performed. Based on the [illegible]

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LETTER FROM WILLIAM M. MILLER, ACTING DIRECTOR, HOUSING MANAGEMENT DIVISION

January [illegible], 1974.

[illegible]

Gloria B. Miller Real Estate Company
612 North Michigan Avenue
Chicago, Illinois 60611

Gentlemen:

Subject: Project No. 071-55124 LDT
4640 North Sheridan Road Building
(formerly Eastwood Towers)

This is to acknowledge receipt of your letter of December 27, 1973 with enclosures. Your letter of October 23, 1973 never reached this office.

A review of your rent rolls point to a violation of the President's Economic Stabilization Program. Apartment rents of $33,930.50 per month were approved under Economic Stabilization Guidelines ~~and you~~ were apparently charging $34,585.00 monthly as of June 1, 1972. Further, a violation of paragraph 4(c) of the Regulatory Agreement is evident in that you have implemented, without our prior approval, additional rent increases to $36,163.00 as of April 30, 1973.

It also appears that in addition to the discrepancies in Monthly Accounting Reports, as set forth in our letter of December 19, 1973, apartment rents were not correctly reported. If the rent rolls as of April 30, 1973 represent rents in effect at that date ($36,163.00), why were potential apartment rents reported as only $33,531.00?

Unless we receive a satisfactory explanation of these apparent violations and revised Monthly Accounting Reports for May through November, 1973 by January 15, 1974, we will have no alternative but to take recourses available to us under the Regulatory Agreement and recommend that our Office of Investigation conduct an audit of the project books and records.

Consideration of your recent request for rent increase is held in abeyance pending resolution of the aforementioned.

Sincerely,

William M. Miller

William M. Miller, Acting Director
Housing Management Division

cc: Docket ✓
F/ W. Pfaender, ATT: E. Roche
ARA for HM, ATT: D. Kaplan

LOCATION [illegible]

SECTION I. VERIFICATION OF EQUIPMENT AND SERVICES INCLUDED IN RENT
(Check applicable items in each column)

| ITEM | A. PREV. APPROVAL | B. EXISTING | C. APPROVED | ITEM | A. PREV. APPROVAL | B. EXISTING | C. APPROVED |
|---|---|---|---|---|---|---|---|
| Ranges (Gas or Electricity) | X | X | X | Electricity to Tenant | — | — | — |
| Refrigerators (Gas or Electricity) | X | X | X | Decorating | X | X | X |
| Laundry Facilities | X | X | X | ~~Furniture~~ A/C Sleeves | X | X | X |
| Water (Hot & Cold) | X | X | X | Other (Specify) Janitor Serv. | X | X | X |
| Space Heat | X | X | X | Grounds Maint | X | X | X |
| Gas to Tenant (Cooking) | X | X | X | | | | |

SECTION II. COMPARISON AND ALLOWANCE OF EXPENSES

| EXPENSE ITEM | A. FORM 2264 Dated 6/9 1965 AMOUNT | B. USED FOR LAST RENT INCREASE Dated 7-27 1972 AMOUNT | C. MORTGAGOR'S STATEMENT Dated 12-31 1978 AMOUNT | D. ALLOWED Dated 3-28 1979 AMOUNT | E. REMARKS |
|---|---|---|---|---|---|
| 1. Advertising | 536 | 530 | 32 | 42 | 2 yr. avg. |
| 2. Commissions | - | 767 | | | |
| 3. Management | 12044 | | 23304 | [illegible] | |
| 4. ~~Custodial Service~~ BAD DEBTS | | | 6712 | [illegible] | |
| 5. Clerical | | 7232 | 7561 | 7561 | [illegible] Mgmt Agent |
| 6. Telephone and Telegraph | | | 457 | [illegible] | |
| 7. ~~Office Expense~~ MISC ADM. | | | 2562 | [illegible] | |
| 8. Legal and Audit | 1505 | 9605 | 5714 | 10063 | actual audit 3 yr avg legal |
| 9. Elevator Power | | | | | |
| 10. Elevator Maintenance | 3000 | 6914 | 7155 | 6351 | actual less refund from R.R. |
| 11. Heating and Ventilating | 14906 | 57347 | 59941 | 59941 | actual |
| 12. Janitorial Expense (Materials) | 1060 | 6120 | 6352 | 6121 | 2 yr avg. |
| 13. Lighting (Misc. Power) | 7684 | 14785 | 18113 | 18113 | actual |
| 14. Water | 2625 | 5951 | 5768 | 5768 | ″ |
| 15. Gas | | | | | |
| 16. Garbage and Rubbish Removal | 1050 | 4785 | 4233 | 4233 | 81727* |
| 17. Payroll | 22929 | 65682 | 81446 | ~~77421~~ | Based on new contract |
| 18. Decorating | 15852 | 16070 | 11785 | 15003 | 4 yr. avg. |
| 19. Repairs | 7689 | 12465 | 12875 | 9575 | 3 yr avg less R.R. |
| 20. Exterminating | 371 | 1266 | 972 | 472 | actual |
| 21. Insurance | 2937 | 6507 | 10547 | 10547 | ″ |
| 22. Grounds Expense (Materials Only) | 252 | 5612 | 266 | 2939 | 2 yr avg. |
| 23. Furniture and Furnishings | 1000 | 1000 | | | |
| 24. | | | | | |
| 25. Misc | | 6747 | OPER. 299<br>MAINT. 252 | 574 | 3 yr avg. |
| 26. TOTAL OPERATING EXPENSES | 45939 | | 266346 | 239539<br>~~255224~~ | * |
| 27. Reserve for Replacements | 12252 | 12252 | 12252 | 12252 | Reg. Agmt |
| 28. Real Estate Taxes | 58376 | 85212 | 82599 | 87292 | actual paid '78-[illegible] |
| 29. Social Security Taxes | 707 | 5247 | 5529 | 5529 | actual |
| 30. | | | | | |
| 31. TOTAL | 767172 | 332696 | 366726 | 344603<br>~~360297~~ | * |
| 32. Management | | 21465 | | 23342<br>27375 | *5% |
| 33. TOTAL | | 353561 | | 372,172 | *372090 |

[illegible] 7/3/79

APPENDIX P,

[illegible] L-D

## CALCULATION OF MAXIMUM PERMISSIVE UNIT RENT FOR 221(d)(3) LIMITED DISTRIBUTION RENT SUPPLEMENT AND BMIR PROJECTS

PROJECT NAME 833 W. Buena Ave Apts NO. 071-55020-LDT

| | | |
|---|---|---|
| 1. | Original Mortgage Amount | $ 2,700,000 |
| 2. | Investment (Equity) | $ 299,970 |
| 3. | a. Interest Rate 3.375 % | |
| | b. Initial Curtail 1.184159 % | |
| | c. MIP (Rent Supplement only) | |
| | d. Total Debt Service Rate 4.559159% | |
| 4. | Line 1 x 3d | $ 123,097 |
| 5. | Line 2 x 6% | $ 17,992 |
| 6. | a. Total Expense, Taxes and Reserves | $ ~~371692~~ 37209 |
| | b. Less Management if a percentage | $ ~~28875~~ 2748 |
| | c. Line 6a less 6b | $ ~~360297~~ 344603 |
| 7. | Sum of Lines 4, 5, 6c | $ ~~501,392~~ 48569 |
| 8. | Adjustment for Management Fees, Vacancy and Collection Losses | |
| | a. 100% Less Management fee as 5 % of Eff. Gross | 95 % |
| | b. Occupancy Estimate | 93 % |
| | c. Line 8a x 8b | 88.35 % |
| 9. | Maximum Allowable Annual Gross Income Applicable to Project (from all sources) Line 7 divided by Line 8c | $ ~~567506~~ 54974 |
| 10. | Less Commercial Rents, Garage Rent and Accessory Income Garage & Laundry (Actual 1978) | $ 22207 |
| 11. | Maximum Gross Unit Rental Income per year | $ ~~545200~~ 5275 |
| 12. | Maximum Gross Unit Rental Income per month (Line 10 divided by [illegible] 12) | $ ~~45442~~ 43961 |
| 13. | Maximum Gross Unit Rental Income average per unit per month (Line 10 divided by number of units) (209) | $ ~~219.43~~ 210.3 |
| | | (1558) 3.67% |

RRS OR SUMMARY DATA

| Existing | | Requested |
|---|---|---|
| 508836 | Per Annum | 537960 |
| 42403 | Per Month | 44830 (5% |
| 202.88 | PUPM | 214.49 |

Prepared by: Ann M Tacchetta Date: 3/28/79
(Signature of Real Property Officer or Designee)

Reviewed and Approved by: Date: 3/29/79
(Signature of Director or Designee)

### SEC. IV. VERIFICATION OF APPROVED REVISED SCHEDULE

| Item | Number | Average Rent Per Month | Total Monthly Rent | Gross Annual Potential Income |
|---|---|---|---|---|
| 1. Rooms | | $ | $ | $ |
| 2. Apartments | | $ | $ | $ |
| 3. Garages | | $ | $ | $ |
| 4. Stores | | $ | $ | $ |
| 5. Gross Annual Potential Income - All Sources (Total of Items 2, 3 & 4) | | | | $ |

3/30/79 553 W. Geneva

40 hr weeks
- 1 month vac Hickson 1525 + Reg.
- 1 month Roosevelt 6.18/hr.
- 3 week James 5.91 hr
- 3 week David 5.91 hr.

6.18
40
247.20
53

247.20
53
74160
123600
13101.60

1525
3050
18300

5.91
40
236.40

236.40
3
709.20

236.40
52
47280
118200
12292.80
709.20
13002.00
26,004
13101.60
39,205.60
183
57,505.60
1525
59,030.60
7720 H & W.
66,750.60
14976
81,726.60

(15,694)

2560
5160
7720

## NOTES FOR MEETING WITH HUD

March 29, 1973

Notes for Meeting with H.U.D., March 29, 1973.

1. After the March 15, 1973 meeting with H.U.D., I received a call from Mr. [illegible], suggesting a waiver of the requirement to deposit $[illegible] per month in the [illegible] fund, for a period of one (1) year, in return of accepting the 12% increase in rents.

This is not acceptable for reasons outlined in my letter to Mr. [illegible] on March 21, 1973.

2. Our legal expenses – up to this [illegible] are as follows:

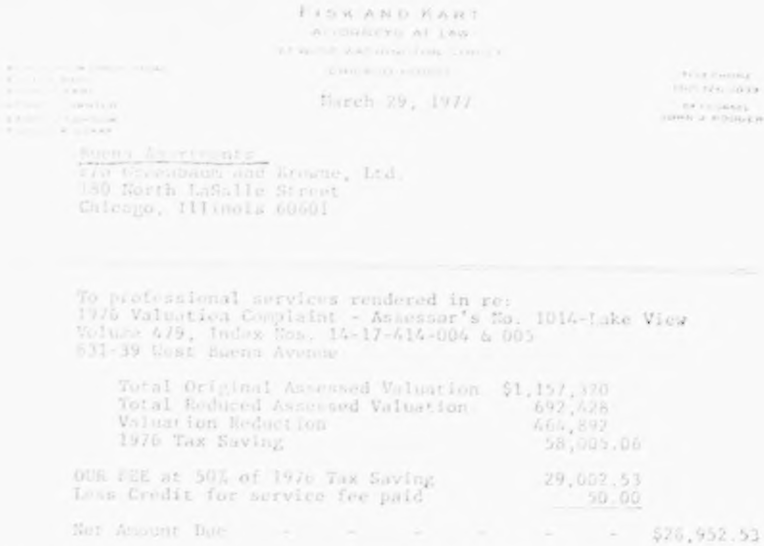
| | | |
|---|---|---|
| a.) | [illegible], [illegible], [illegible] & Mahin<br>Accountants' fees – 1972<br>Legal fees for 1971 tax reduction | <br>$47,201.00<br>11,000.00 |
| | TOTAL: | $58,201.00 |
| b.) | [illegible], [illegible], Sheppard & [illegible]<br>[illegible] et al vs. H.U.D., et al<br>Oct., 1972<br>Nov., 1972<br>Dec., 1972<br>Jan., 1973 | <br><br>$ 2,778.00<br>1,[illegible].75<br>[illegible].25<br>[illegible].03 |
| | TOTAL: | $ 6,[illegible].93 |

3. Extraordinary expenses – not included in the normal operation cost – for the next 6 to 12 months.

| | | |
|---|---|---|
| a.) | Chimney work, as per Chapter 78, s.28, City of Chicago, contract let March 21, 1973 | $ 3,[illegible].00 |
| b.) | Tuckpointing and caulking | 7,500.00 |
| c.) | Complete decorating of all corridors, lobby, laundry room and all public areas, now in progress | 12,000.00 |
| d.) | Replacement of booster pumps, as per letter, H.U.D., March 14, 1973 | 1,900.00 |
| e.) | Ventilation of basement, as per above letter, contract let | [illegible].00 |
| | TOTAL: | $25,375.00 |
| | Total immediate expenses:<br>Legal fees<br>Construction etc. | <br>$64,518.93<br>25,375.00 |
| | TOTAL: | $89,893.93* |

*Not including legal fees in connection with litigation, due after February 1, 1973.

4. It is the understanding of the ownership, that the primary objective of the 221 (d) (3) legislation was to provide moderate income housing, commensurate with the economic principle, to provide a 6% return on the investment made by the sponsors of such housing. With the 6% return also the building should carry itself, which [illegible] the 6% return on the investment, provided for by law and by F.H.A. commitments, in which incidentally, residents of the building were not a party. Consequently, such action by or in behalf of the tenants are looked upon as encroachment on the right and interference with the business of the sponsors to live up to their obligations to H.U.D., to the tenants and to themselves.



FISK AND KART

ATTORNEYS AT LAW

March 29, 1977

Buena Apartments
c/o Greenbaum and Browne, Ltd.
180 North LaSalle Street
Chicago, Illinois 60601

To professional services rendered in re:
1976 Valuation Complaint - Assessor's No. 1014-Lake View
Volume 479, Index Nos. 14-17-414-004 & 005
631-39 West Buena Avenue

| | |
|---|---|
| Total Original Assessed Valuation | $1,157,320 |
| Total Reduced Assessed Valuation | 692,428 |
| Valuation Reduction | 464,892 |
| 1976 Tax Saving | 58,005.06 |
| OUR FEE at 50% of 1976 Tax Saving | 29,002.53 |
| Less Credit for service fee paid | 50.00 |
| Net Amount Due - - - - - - - | $28,952.53 |

## STATEMENT OF FLORENCE W. ROISMAN, WASHINGTON OFFICE, NATIONAL HOUSING LAW PROJECT

## ACCOMPANIED BY MARILYN COHEN •

### PREPARED STATEMENT

Senator PROXMIRE. Our next witness is Ms. Florence Roisman of the Washington office of the National Housing Law Project, a national organization which helps local legal services attorneys in representing low-income tenants and homeowners. She is accompanied by Marilyn Cohen.

Ms. Roisman, it is good to have you with us today. Is Ms. Cohen here, too? Why don't you come up also. I see you have a 34-page written statement, Ms. Roisman.

Ms. ROISMAN. With your permission, Senator, we will submit that for the record.

Senator PROXMIRE. If you could make your presentation in about 10 minutes, we would very much appreciate it.

Ms. ROISMAN. I think we can do that.

Senator PROXMIRE. We will have your statement printed in full in the record.

[The statement follows:]

## STATEMENT OF FLORENCE W. ROISMAN, NATIONAL HOUSING LAW PROJECT

### I. INTRODUCTION

We wish to thank the Committee for giving the National Housing Law Project the opportunity to submit a written statement and to testify at the hearings being held on HUD's multifamily projects. For over ten years, the National Housing Law Project has assisted local Legal Services attorneys in representing low-income tenants and homeowners. We have worked extensively on issues related to the management and disposition of HUD-assisted, HUD-held, and HUD-owned multifamily projects.

In addition, approximately three years ago the Housing Law Project established a component known as the Multifamily Demonstration Program to work almost exclusively on seeking solutions to the financial and management crises besetting this housing. Four major interrelated activities have been carried out under that program:

A. Comprehensive audits of five troubled subsidized projects;

B. On-site technical assistance to the audited developments to help implement the recommendations contained in the audit reports;

C. Position papers and memoranda on various housing policies and practices of HUD; and

D. Training for HUD loan management staff, based on the lessons and techniques learned as a result of the above activities.

The combined experience of the National Housing Law Project and its Multifamily Demonstration Program has provided the basis for this statement.

The testimony which has been presented at these hearings has focused on the failings of owners, managers, and HUD. These are issues which need to be addressed. But we urge the Committee in addressing these issues not to lose sight of the need which low-income people have for subsidized housing and the ways in which such housing can be improved and preserved for low-income use. The federal government has spent billions of dollars to build housing for low-income people. It is essential that Congress now act to ensure that this investment will continue to be available to serve them.

While many of the proposals presented in this statement will require new authorizations and will have to be presented to the Senate Banking, Housing and Urban Affairs Committee, the proposals will also require appropriations. We therefore are presenting them to this Committee for its full consideration.

A. The Need for Low-Income Housing

The need for low- and moderate-income housing in America is clear. There are upwards of 14 million households in this nation with incomes below 125 percent of the poverty level. They constitute 17.7% of all households in the country. Mean income for families in this category is less than $5,000 per year. Mean income for individuals is less than half that amount. It is self-evident that these people simply do not have the means, without government aid, to meet the rising cost of housing. If they are to have shelter, it is vital that we preserve and continue to subsidize every unit of housing that has been built for low-income use.[1] And it is essential that we preserve these units now. These projects were built at a time when construction costs and mortgage costs were considerably lower than they are now. While we do not have precise figures, we would venture to say that the costs of replacing just the 325,000 units presently in the HUD-held and -owned inventory would come to almost $10 billion. Replacement of those units which are presently assisted should they be lost from the low-income inventory would cost many billions more.

In addition, the supply of low-income housing in the country is shrinking. The Comptroller General of the United States, in a study entitled Section 236 Rental Housing--An Evaluation With Lessons for the Future, January 10, 1978, p. 64, reported that between 1970 and 1974, the total number of rental units in the country renting for less than $150 per month decreased by nearly 3.8 million while the number of renter households which could easily afford to pay no more than $150 per month for rent decreased by only 1.5 million households. Given these statistics, it is essential that the government act to preserve every unit of government assisted, financed, or insured low-income housing.

## B. Congressional Commitment To Providing and Preserving Low-Income Housing

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[1] It is no answer to the problem to say that middle- and upper-middle income families are feeling the effects of inflation too. While these families may be feeling pinched, they are not confronted with the disastrous situation which low-income families are facing. The well-to-do simply have more disposable income with which to meet the problem. In 1977, for example, "the median very low-income renter paid $120 per month for shelter, including utilities. The median renter with more than ten times the income paid only two- and one-half times as much rent. In other words, after allowing for shelter costs, the richest renter household had more than twenty times the disposable income of the poorest renters." Statement of former Senator Brooke, 125 Cong. Record S14209 (Oct. 5, 1979). In sum, middle- and upper-middle income Americans can meet the inflation in housing; low-income Americans cannot do so without government aid.

Congress has long been concerned with the need to provide and to preserve housing for low-income people. Since the Roosevelt era, Congress has declared it to be a goal of the United States government to provide decent, safe and sanitary dwellings for the poor. The policy was first stated in Section 1 of the United States Housing Act of 1937:

> It is hereby declared to be the policy of the United States . . . to assist the several States . . . *to remedy* the unsafe and unsanitary housing conditions and *the acute shortage* of decent, safe and sanitary dwellings *for families of low income* . . . (42 U.S.C. Section 1401.) (Emphasis added.)

The goal was reiterated and emphasized in the Housing Act of 1949, when Congress set a national goal of a "decent home and a suitable living environment for every American family." 42 U.S.C. Section 1441. In 1968, Congress restated the goal in even more explicit terms and required that HUD place its highest priority and emphasis on achieving the goal for low-income people. In Section 2 of the Housing and Urban Development Act of 1968, 12 U.S.C. Section 1701t, Congress declared:

> . . . [I]n the administration of those housing programs authorized by this Act which are designed to assist families with incomes so low that they could not otherwise decently house themselves, and of other Government programs designed to assist in the provision of housing for such families, *the highest priority and emphasis should be given to meeting the housing needs of those families for which the national goal has not become a reality*; . . . (Emphasis added.)

In 1974, Congress again addressed the issue of achieving the national housing goal and the problems arising from the increasing abandonment and neglect of the existing stock of low-income housing. As a result of its concern, Congress amended Section 1601 of the Housing and Urban Development Act of 1968, and directed HUD to place a "greater effort" on the preservation of existing housing for lower-income people.

In 1978, Congress addressed the same issue of neglect in the context of the existing inventory of HUD-owned multifamily housing stock and directed the Secretary to further the goals of:

> "(1) preserving the housing units so that they can remain available to and affordable by low- and moderate-income families;
>
> (2) preserving and revitalizing residential neighborhoods;
>
> (3) maintaining the existing housing stock in a decent, safe and sanitary condition;
>
> (4) minimizing the involuntary displacement of tenants; and
>
> (5) minimizing the need to demolish projects."

Consistent with these goals, the 1978 amendments also provided for tighter management procedures for HUD-owned multifamily projects, greater tenant participation, and operating assistance for troubled multifamily housing projects.

We urge Congress in 1980 to continue its commitment to these national housing goals and to enact legislation and appropriate funds which will ensure that the inventory of subsidized multifamily properties will remain available as decent, safe, and sanitary housing for low-income people.

## II. PROBLEMS FACING LOW-INCOME PROJECTS

### A. Inadequate Funding and Inadequate Management and Monitoring

Despite Congress' good intentions, subsidized projects are in difficulty. There are two major reasons causing the problem. First, the fixed interest reduction subsidies on which the Sections 221(d)(3)and 236 programs are based are inadequate in a period of high inflation. While the subsidy provides assistance on the debt service, it does not address the increasing costs of property taxes, maintenance, and utilities. As a result, as project costs go higher and higher, project owners are raising rents. Many low-income tenants are forced to vacate their units because the units are no longer affordable. In addition, many tenants are now paying between 40%-60% or more of their income for rent. But it is not only tenants who suffer. When rental income cannot keep pace with expenses, conditions in the projects deteriorate for there are insufficient funds for proper maintenance. Once a project gets into such difficulty, the deterioration accelerates and is most severe from the time of default to the time of foreclosure.

The second reason for project difficulty is poor management on the part of owners, often compounded by poor monitoring by HUD.

### B. Addressing These Problems Before Projects Go Into Default

The Government's investment in low-income housing can best be safeguarded by addressing these problems before projects go into default and assignment.

When a project goes into assignment, the government is contractually obliged to pay to the holder of the mortgage the outstanding mortgage balance plus accrued interest. Payment of the insurance claim at the time of assignment is far and away the major financial loss suffered by the government in the entire default-assignment-foreclosure-disposition process. In addition, it is assignment which brings about the need for treasury borrowings -- with the attendant interest costs -- and subsequent appropriations to replenish the insurance funds. Even if HUD was a model of efficiency and competence in executing its responsibilities during the period of assignment and subsequent HUD ownership, it would make no significant dent in the loss occasioned by payment of the insurance claim. Thus, if any signficant steps are to be taken by the Congress to rescue the insurance funds and, by no means incidentally, to pull HUD from the swamp of its property disposition program, it must address the assignment issue. Simply put, the question is, how are these projects to be kept out of default and preserved over the long term as decent housing for low- and moderate-income people?

## III. LEGISLATIVE PROPOSALS TO PREVENT ASSIGNMENTS

In order to meet the problems facing the low-income multifamily projects and to prevent assignments, Congress needs to enact legislation which will

- provide a long-term tenant-based subsidy which will fix tenant rents, including utilities, at levels which low-income people can afford, and which will last for the remainder of the project mortgage or the remaining life of the building, if such life exceeds the mortgage term;
- ensure that management of the projects will be improved, and that the projects will be operated in the most cost efficient manner consistent with the owners' obligations;
- ensure that the projects will be fully utilized; maintained in decent, safe, and sanitary condition; and preserved for low- and moderate-income use;
- ensure that HUD's monitoring capability is improved; and
- provide for judicial review and private causes of action to ensure agency and owner compliance with statutory obligations.

As discussed below, legislation to accomplish these goals will be less costly to the federal government than the cost of allowing the projects to go into default, assignment, and foreclosure.

### A. A Long Term Tenant Based Subsidy

#### Setting Tenant Rents at 25% of Income

It is essential that Congress enact a program and appropriate funds for a long-term tenant based subsidy. The flexible subsidy program, enacted in 1978, has been conceived as a short-term assistance program to correct deficiencies in projects caused by deferral of regularly scheduled maintenance or the failure to make necessary and timely replacement of equipment and other capital items. After the flexible subsidy for a given project is exhausted, the only source of revenue will be from rent increases. In order to keep the projects which receive the flexible subsidy as low-income housing, Congress must provide long-term tenant based subsidies for the low-income tenants who reside there. If it fails to do so, the millions which will be spent on the flexible subsidy will have been spent for middle-income rather than low-income people, for it will only be middle-income people who will be able to afford the rents. The same is true for the remainder of the subsidized projects[2] and non-subsidized projects serving low-income tenants.[3] Unless the tenants receive a long-term tenant-based subsidy, the properties will cease to be available to low-income people.

Given the tremendous need which very low-income people (those with incomes at 50% of median or less) have for housing and the limited supply of subsidized units, the units and the tenant-based subsidy should be directed to tenants whose incomes fall within the very low-income category.

The subsidy program should set rents at 25% and should include utilities or a reasonable allowance for utilities within the 25% figure. The 25% of income figure has been used in the public housing, rent supplement, and Section 8 programs.[4] Given the very limited disposable incomes of very low-income people, 25% of income for rent should be the very maximum that they should be required to pay.

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[2] Subsidized projects include those assisted under Section 236 or the proviso of Section 221(d)(5) of the National Housing Act, and those assisted under Section 202 of the Housing Act of 1959.

[3] Non-subsidized projects serving low-income people include projects financed or insured under Sections 207, 231, and 221(d)(4) and 608 of the National Housing Act, and other programs.

B. Conditions Attached to the Subsidy

As conditions for receiving the subsidy, Congress should require that

(1) the owner shall agree to maintain the project as low-income housing for the remainder of the life of the mortgage or the remainder of the life of the building, if such life exceeds the mortgage term. Due to inflation, the changed real estate market, and the nature of the tax shelter governing subsidized projects, owners, in increasing numbers, will be seeking to prepay their mortgages and convert their projects to middle-income use. A prohibition on such conversion is therefore necessary. *See* Section 211(c) of the Housing and Community Development Amendments of 1979, requiring that owners who receive assistance under the flexible subsidy program agree to maintain the project as low- and moderate-income housing for the remaining life of the mortgage.

(2) the owner shall improve the management of the project and institute such cost controls, management efficiency systems and other measures deemed necessary by the Secretary to improve the management of the projects. *See* Section 201(d)(5)

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[4] The 25% of income figure still continues as the maximum for very low-income tenants in the Section 8 program. See Section 202(b)(A) of the Housing and Community Development Amendments of 1979.

and (6) and Section 203(b)(1)(B) of the Housing and Community Development Amendments of 1978 requiring competent management as a pre-condition for the receipt of assistance under the flexible operating subsidy and for the purchase of a project.

(3) the owner, to the greatest extent possible, shall maintain full occupancy in the projects. This obligation directly parallels the obligation imposed on the Secretary in regard to HUD-owned projects. See Section 203(c)(2) of the Housing and Community Development Amendments of 1978.

(4) the owner shall comply with all provisions of the project Regulatory Agreement. This provision is designed to require the Secretary to enforce the conditions of the regulatory and other agreements which the owners have signed.

(5) the owner shall maintain the project in a decent, safe and sanitary condition, and in compliance with all applicable state and local laws and regulations governing the habitability of rental housing, and shall warrant the habitability of the projects. The first clause -- the decent, safe, and sanitary provision -- directly parallels the requirement imposed on the Secretary in regard to HUD-owned projects. See Section 203(c)(1) of the Housing and Community Development Amendments of 1978. The second clause -- requiring compliance with state and local codes -- is added to ensure that conditions in HUD-assisted properties do not fall below those required of other properties in the area. The third clause -- requiring a warranty

of habitability -- is added to give tenants the right to enforce the protections afforded by this section.

(6) the owner shall implement necessary security measures. The problem of security has been a major concern in HUD projects. Congress, in Section 207 of the Housing and Community Development Amendments of 1978, required HUD to address the problem of security in public housing projects. This condition for receipt of the subsidy would require that security measures be taken in HUD-subsidized housing as well.

(7) the "basic" rent or rent for the unit shall be based on the reasonable cost of operating the project and shall not be determined by that which the traffic will bear. In addition, an increase in the "basic" rent or the rent for the unit shall not be granted if the increase in operating expenses are not reasonable or comparable to cost increases affecting other similar rental projects in the community, or if the increases in operating expenses could have been avoided through the use of reasonable cost controls or management efficiency systems, or the project owner has violated any of the conditions governing receipt of the subsidy. These provisions are added to ensure that rents are monitored by HUD and based only on reasonable costs of running the project. They are designed to prevent wasteful, inefficient management. They mandate not only that increases be reasonable, but that, if available, affirmative cost saving devices be employed. This should result in a reduction in the amount

of yearly subsidy needed by a project. The section also prevents rent increases unless the owner complies with the conditions governing the subsidy, thus providing an added requirement for HUD monitoring.

C. Comparison: Cost of Tenant Based Subsidy vs. Project Failure

Our proposal for a tenant based subsidy is supported by sound cost considerations. Based upon our calculations[5] the cost to the government of cycling a project through assignment, foreclosure and eventual property disposition with Section 8 exceeds by at least 15% the cost of a tenant based subsidy designed to keep the project out of default. This estimation is based upon figures that are not discounted to account for the time value of money. If reasonable discounting assumptions are employed,[6] the cost variance exceeds 40%. Furthermore, these results are based upon extremely conservative assumptions regarding HUD property disposition experience. Our projections assume that HUD recovers 64% of its net capitalized costs through sale of a project, whereas HUD's Final Report of the

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[5] The assumptions and figures underlying our projections are derived from a number of sources. The assumptions regarding the original cost of the project, the terms of the original mortgage, current operating expenses and current tenant income levels are based upon the actual experience of representative subsidized projects in financial distress in the San Francisco/Oakland S.M.S.A. The Multifamily Demonstration Program of the National Housing Law Project has been working closely with such projects during the past two and one-half years pursuant to grants from HUD, the Ford Foundation and others.

The rates employed for projecting future increases in utility costs and other operating expenses, Section 8 existing housing fair market rents, and tenant incomes are drawn from the recent budget issue paper of the Congressional Budget Office, entitled The Long-Term Costs of Lower-Income Housing Assistance Programs (March 1979).

[6] The discounting assumptions involve the discounting of annual cash flows at a discount rate of 8.0%.

Multifamily Property Utilization Task Force (May 1978) reveals that HUD's past recovery rate has been closer to 30%. If the 30% rate were used in the projections, the cost effectiveness of the tenant based subsidy would be even greater. Therefore, notwithstanding a most generous allowance in HUD's favor regarding its ability efficiently to acquire and dispose of financially distressed projects, it would be significantly cheaper to provide a tenant based subsidy to keep the project out of default in the first place.

We would be pleased to share our analysis of the cost of the subsidy with the Committee and its staff. We also urge the Committee to request an official analysis by the Congressional Budget Office or the General Accounting Office.

However, even if the cost of providing a tenant-based subsidy were higher than the cost of assignment, foreclosure, and resale, it is essential that the expenditure be made and the tenant-based subsidy be provided. We spend twice as much via tax subsidies for middle- and upper-income housing than we do for subsidies for low-income people. If we as a nation are committed to helping the rich, we can have no less of a commitment to helping the poor.

Figures on the annual loss to the Treasury due to tax write-offs on housing were prepared by the Congressional Budget Office in a study entitled Real Estate Tax Shelter Subsidies and Direct Subsidy Alternatives. The study was prepared in response to a request from Chairman William Proxmire of the Senate Committee on Banking, Housing and Urban Affairs, Chairman Henry S. Reuss of the House Committee on Banking, Finance and Urban Affairs, and then-Chairman Brock Adams of the House Committee on the Budget.

The CBO reported:

- In fiscal year 1978, the tax expenditure for mortgage interest and property taxes on owner-occupied homes was $10.2 billion. Id. at 39.

- The deferral of capital gain on home sales provided another loss to the Treasury estimated at $0.9 billion in fiscal year 1978. The excess bad debt reserves of savings and loans and mutual savings banks also provided an indirect subsidy for homeownership, amounting to a tax expenditure of $0.5 billion in fiscal year 1978. Id. at 39-41.

- In contrast, the federal government's direct outlay, credit assistance, and tax expenditures for low-income housing was half that amount. According to CBO estimates, the federal government would provide in fiscal year 1978 only $4.0 billion in direct outlay and credit assistance subsidies for rental housing;7/ $1.3 billion in assistance for owner-occupied housing;8/ $0.4 billion for tax-exempt local housing authority bonds for the construction of low-income public housing; and $0.2 billion for tax-exempt bonds for low- and moderate-income private rental housing built with the assistance of state housing agencies. Id. at 41-43.

- As to the percentage of the $1.3 billion fiscal year 1978 tax shelter for past and current real estate construction, CBO found that:

  --35% of this subsidy would go to assist the construction of commercial buildings -- office buildings, shopping centers, and the like;

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7 The entire $4.0 billion should not be included in the cost of assisting low-income housing. CBO noted that while most of the rental housing programs are aimed at low- and moderate-income rental housing, a substantial share of the GNMA Tandem Assistance goes to middle- and upper-income rental housing, as does a portion of the Section 202 Housing for the Elderly or Handicapped subsidy. Id. at 41.

8/ Here again, the entire $1.3 billion cannot be included in the cost of assisting low-income housing. The owner-occupied assistance was provided through FHA, VA, and Farmers Home Administration mortgage insurance, guarantee, and direct loan programs, the GNMA Tandem Plan, and the Section 235 homeownership subsidy program for low-income families. As CBO noted, with the exception of the Section 235 program, almost all of the homeownership subsidy programs are aimed at middle- to upper-middle income families and individuals. Id. at 43.

--54% would go to assist the construction of middle- and upper-income rental housing, mostly apartment buildings; and

--only 11% of the total would go to assist low-income rental housing. Id. at 37.

We urge the Committee to keep these figures in mind in its deliberations on providing a tenant based subsidy for low-income people.

D. Improving HUD's Management and Oversight Capabilities

In addition to providing a tenant-based subsidy to aid tenants and to prevent the subsidized projects from going into assignment, Congress must support HUD in its efforts to improve its management and oversight capabilities. We have found that:

a. The vast majority of subsidized housing is owned and managed by individuals and organizations whose activities and operations must be closely monitored for compliance with HUD statutes, regulations and handbooks;

b. Most HUD area office staffs are not effectively managing their subsidized housing inventory and require additional resources and training;

c. HUD staff members are often too ready to assume, without investigation, that a proposed solution is foreclosed by legal, administrative or political barriers; and

d. HUD staff members are seldom providing the training in basic management skills, assistance, and continuing education which many management companies and on-site staff require in order to provide even a minimally acceptable level of service.

HUD has taken some initiatives to improve its monitoring capabilities. While HUD has proceeded too slowly, they are clearly heading in the right direction. We therefore urge

Congress to support HUD in its efforts to provide owners and managers with a broad range of technical assistance. A significant number of housing developments need direct "hands-on" technical assistance from individuals skilled in finance, property management and negotiation. There is no established, or identified, alternative organization capable of performing the management oversight and technical assistance functions assigned by Congress to HUD. Therefore, Congress must adequately fund and support new management initiatives by HUD, particularly requests for increases in Central Office and field staff. In addition, ways must be found to permit HUD to recruit and hire the people with the experience and skills needed to deal with the new, demanding tasks of management oversight and technical assistance and to provide quality, in-depth training for existing personnel. Failure to support and fund the management initiatives and technical assistance needs will lead to a greater overall cost to the government and to low- and moderate-income families, as the housing stock deteriorates or is lost to the families it was intended to serve.

Finally, additional funds must be made available for continued exploration of ways to supplement HUD's existing management and oversight capabilities.

In the event, however, that the management of a project is not improved and the project is not being maintained as required by statute, regulations, or contractual obligations, a non-financial default should be declared promptly so that the project can be assigned to the Secretary, foreclosed, and sold to proper owners. This Committee, in its report, should, therefore, assert that Congress expects HUD to foreclose for major non-financial defaults of the statutes, regulations, or contractual obligations governing a project whenever foreclosure is the best way of maintaining the housing for low- and moderate-income people.

## IV. LEGISLATIVE PROPOSALS TO GOVERN THE PERIOD BETWEEN ASSIGNMENT THROUGH FORECLOSURE PROCEEDINGS

The preceding discussion was aimed at legislative action which is needed to prevent projects from going into default and assignment. But there are projects, as the Committee well knows, which are already in default and assignment and other projects which will enter that status while Congress is considering what to do and drafting necessary legislation. As to those subsidized projects and non-subsidized projects which are serving or could serve low-income people, which are currently in default and assignment or which go into default and assignment in the future, it is essential that Congress take action which will:

- ensure that HUD maintain the buildings in decent, safe and sanitary condition and comply with all of the conditions listed above as conditions for receipt of the tenant-based subsidy or comply with the requirements imposed by Section 203 of the Housing and Community Development Amendments of 1978 for HUD-owned projects.
- set rents at 25% of income.
- Provide procedures which will ensure fast foreclosure and ensure preemption of conflicting local and state laws;
- provide restrictions on foreclosure sales which will require the purchaser to satisfy certain management and ownership standards, and which will require that buildings remain as low-income housing for the remaining period of the original mortgage, or the life of the new mortgage, whichever is longer, or the life of the building if it exceeds either of the above mortgage terms.
- require HUD to report foreclosures to the Internal Revenue Service to ensure recapture of the tax sheltered funds. And
- amend the new bankruptcy law to exempt HUD-insured projects from the "cram down" provisions.

### A. HUD's Obligation to Maintain the Property In Decent, Safe and Sanitary Condition

and to Comply With Other Requirements

The obligations proposed above as conditions for receipt of the tenant based subsidy or the obligations imposed upon HUD by Section 203 of the Housing and Community Development Amendments of 1978 for the period of HUD ownership should be imposed upon HUD during the period in which a project mortgage is assigned to the agency. It is essential that these projects be maintained in decent, safe and sanitary condition; that, to the greatest extent possible, the projects be fully utilized; that they be kept secure, and that they be kept repaired.

HUD has been criticized for its use of the General and Special Risk Insurance Funds for HUD-held projects, i.e., projects assigned to the agency. Yet, HUD has had the power since the insurance programs were created "to take such action and advance such sums as may be necessary to preserve or protect the lien of . . . [the] mortgage" on projects which have been assigned to the Secretary. Section 207(k) of the National Housing Act, 12 U.S.C. Section 1713(k). Rather than criticizing HUD for preserving these projects, Congress should either state in report language that Section 207(k) authorizes HUD to advance sums from the insurance fund to keep the projects in decent, safe, and sanitary condition, do necessary repairs, provide security, and do work that is necessary to allow full occupancy,9/ or should enact legislation which explicitly gives HUD these powers.

B. Rent Levels During Assignment

Rent levels should be set at 25% of tenants' adjusted gross income, as discussed earlier in connection with the tenant-based subsidy.

C. Fast Foreclosure Provisions

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9 The Comptroller General has in fact affirmed that HUD has such power. 54 Comp.Gen. 1061 (1975).

The Housing Law Project agrees with the Committee's Investigations Staff report on the need for HUD to establish specific criteria on when and if to foreclose, the need to overcome the reluctance to foreclose that often exists within HUD, and the need to develop and implement streamlined foreclosure procedures. It has been well documented by HUD and others that once the decision to foreclose is made, an expedited process is essential to reduce costs, prevent further deterioration of the property, and eliminate the revenue loss to the U.S. Treasury occasioned by the continuation of owners' tax shelters during the pendency of foreclosure proceedings.

As early as 1973, a bill10/ was introduced in Congress that would have established an expedited foreclosure process for properties with mortgages made, owned, insured or guaranteed in whole or part by the United States. The Housing Law Project urges Congress, as soon as possible, to enact legislation creating an expedited foreclosure process for multifamily insured and subsidized housing. The statute should provide for a speedy process consistent with basic elements of due process of law; provide for non-judicial foreclosure except for the availability of judicial review to guard against arbitrariness and denials of due process; and ensure HUD's authority, as necessary, to quickly assume management of the property during the pendency of any foreclosure process and any related judicial proceedings.

### D. Low-Income Use Restrictions on the Foreclosure Sale

Congress, in Section 203(a) of the Housing and Community Development Amendments of 1978, required that after foreclosure, formerly subsidized projects shall be resold in a manner which will further the goals of

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10 The bill was incorporated in S. 3066, 93d Cong., 2d Sess. (the Senate version of the 1974 Housing Act) and deleted in conference.

"(1) preserving the housing units so that they can remain available to and affordable by low- and moderate-income families;

(2) preserving and revitalizing residential neighborhoods;

(3) maintaining the existing housing stock in a decent, safe, and sanitary condition;

(4) minimizing the involuntary displacement of tenants; and

(5) minimizing the need to demolish projects."

Legislation is needed which will place the same restrictions on sale of formerly subsidized projects at foreclosure sales. With the increase in real estate values, HUD will be outbid at foreclosure sales and the projects will be lost from the low-income market unless Congress enacts legislation which requires that the projects will remain as low-income housing for the remaining period of the original mortgage or the life of the new mortgage, whichever is longer, or the life of the building, if it exceeds either of the above mortgage terms. The legislation must also impose restrictions regarding ownership and management capability and give HUD the same powers regarding the method of sale as Congress provided in Section 203 of the 1978 Act in regard to projects sold after foreclosure.

Such legislation would not only be consistent with the 1978 Housing and Community Development Amendments of 1978, and the national housing goals, Section 2 of the Housing Act of 1949, but would also fulfill the original intent of Congress in creating the subsidized programs. In the report accompanying the creation of the Section 236 program, the Senate Committee explicitly stated:

> In connection with rental or cooperative projects in which the mortgage is foreclosed and the property conveyed to the Secretary, the committee expects the Secretary (as he would also do in connection with rent supplement projects) to operate the project at rental rates adjusted in accordance with tenants' income and consistent with the objectives

> of the program (Senate Committee on Banking and Currency, 90th Cong., 2d Session, S. Rep. 90-1123, p. 26).

Legislation imposing restrictions on the foreclosure sale is essential if these low-income objectives are to be met.

## E. Reporting Foreclosures to the Internal Revenue Service To Ensure Recapture of Tax Shelters

Under certain circumstances, foreclosure of a HUD insured project triggers recapture by the U.S Treasury of a portion of the tax shelter benefits which accrued to the owners. In the past, little coordination existed between HUD and the Internal Revenue Service to assure that the recapture provisions of Internal Revenue Code were enforced. Recent reports indicate that steps have been taken to create such linkages. This Subcommittee should take steps to assure that those mechanisms are firmly in place and that they are promoting effective enforcement.

## F. Revision of the "Cram-Down" Provision of the New Bankruptcy Law

The Bankruptcy Reform Act became effective on October 1, 1979. It now governs liquidations or reorganizations of the owners of subsidized properties and could permit owners of such projects to escape low-income use limitations and either rent or sell units to upper-income people or sell the building free of the use limitations.

It was possible under the former Bankruptcy Act, and continues to be possible under the Reform Act, to force terms upon creditors in reorganization that differ substantially from the remedies and other rights that the creditor had established with the debtor by contract. This process of "rewriting" the creditor's contract is referred to as "cram down".

Under the old Bankruptcy Act, however, an exemption from cram down and other provisions existed in connection with mortgages insured under the National Housing Act. Under the Reform Act, however, there is no such exemption. Under the new law, while there continue to be numerous general protections for secured creditors, HUD is denied any favored status and is treated on the same basis as a private creditor.

This situation might lead to the following scenario: A project owner, with HUD as its major secured creditor and numerous general creditors, files for reorganization under Chapter 11 of the Bankruptcy Reform Act. If the property is particularly valuable or has potential as upper-income housing, the reorganization plan simply calls for the lifting of the low-income use limitations. Based upon higher potential rents or potential condominium sales, the owner is able to establish that all creditors, including HUD, would receive full payment of their claims if the use restrictions were terminated. In this situation, consequently, the owner might be permitted to maintain its ownership of the project, escape the low-income use restrictions, and profit substantially from the property in its unrestricted state.

The Reform Act should be amended promptly to reestablish the exemption from "cram down" for HUD-insured projects.

## V. LEGISLATIVE PROPOSALS TO GOVERN THE PERIOD OF HUD OWNERSHIP AND SUBSEQUENT SALE

### A. Expenditures For Repairs and Maintenance During HUD's Ownership

HUD has been criticized for the expenditure of funds from the insurance funds for the repair of projects, yet HUD has both the power and the obligation to make such repairs and payments. Section 203 of the Housing and Community Development Amendments of 1978 provides, *inter alia*:

"(a). . . [t]he purpose of the property

> management and disposition program of the Department of Housing and Urban Development shall be to manage and dispose of projects in a manner which will protect the financial interests of the Federal Government and be less costly to the Federal Government than other reasonable alternatives by which the Secretary can further the goals of--
>
> (1) preserving the housing units so that they can remain available to and affordable by low- and moderate-income families;
>
> . . .
>
> (3) maintaining the existing housing stock in a decent, safe, and sanitary condition; [and]
>
> . . .
>
> (5) minimizing the need to demolish projects. [And]
>
> (c) Except where the Secretary has determined on a case-by-case basis that it would be clearly inappropriate, given the manner by which an individual project is to be managed or disposed of pursuant to subsection (a) of this section, the Secretary shall seek to--
>
> (1) maintain all occupied multifamily housing projects owned by the Secretary in a decent, safe, and sanitary condition; and
>
> (2) to the greatest extent possible, maintain full occupancy in all multifamily housing projects owned by the Secretary."
>
> (Emphasis added.)

In addition, Section 207(l) of the National Housing Act, 12 U.S.C. Section 1713(l), provides in pertinent part:

> "Notwithstanding any other provisions of law relating to the acquisition, handling, or disposal of real and other property by the United States, the Secretary shall also have power, for the protection of the interests of the General Insurance Fund, to pay out of the General Insurance Fund all expenses or charges in connection with, and to deal with, complete, reconstruct, rent, renovate, modernize, insure, make contracts for the management of, or establish suitable agencies for the management of, or sell for cash or credit or lease in his discretion, any property acquired by him under this section;. . . (Emphasis added.)

Rather than faulting HUD for making repairs to projects, the Congress should explicitly state that HUD has the power and obligation to make such repairs, and should require HUD to make them.

HUD, in its recent Amendments to the Section 8 Program Regulations for the Disposition of HUD-Owned Projects, 44 Fed. Reg. 70362-70377, has stated that it will only make repairs when the Department determines that there is an immediate threat to the health and safety of the tenants. Id. at 70362. HUD has the obligation under the 1978 statute to do more. It must maintain the projects in decent, safe and sanitary condition -- not just deal with immediate threats to health and safety. The Committee should therefore require HUD to adopt a policy and issue regulations which comply with their statutory obligations.

### B. Tenant Rent Levels During HUD Ownership

Given the very limited incomes of tenants in formerly subsidized projects, the tenants should not be required to pay more than 25% of income for rent including utilities. As discussed earlier, the 25% of income amount has been used in the public housing and rent supplement programs, has been retained for very-low income tenants in the Section 8 program, and should be applied in government-owned projects and projects re-sold by the government.

### C. Improvement of HUD's Management and Oversight Capabilities During HUD Ownership

HUD must ensure that it has the ability to manage and oversee the projects once they come into its inventory. The problems during this period are generally the same as those facing HUD during assignment, except that HUD is directly responsible for the operation of the project. The discussion, supra, regarding improvements in HUD's management capabilities during assignment is therefore applicable here.

### D. Use of a Long Term Tenant Based Subsidy Following Resale of the Projects

Unless a long term tenant-based subsidy is made available following resale of the projects, the buildings will be lost from the low-income market. Congress, in enacting the subsidized housing programs, provided for subsidies which would last 40 years. Congress intended that the projects would remain low-income for at least that period.11/ In addition, Congress, in 1978, as discussed above, required HUD to dispose of formerly subsidized HUD-owned projects in a manner which will make them available to and affordable by low- and moderate-income people, and in a manner which will minimize the involuntary displacement of tenants. See Section 203(a) of the Housing and Community Development Amendments of 1978. Only a long term tenant-based subsidy, as discussed above, will ensure the continued low- and moderate-income use of the projects.

## VI. LEGISLATIVE PROPOSALS CREATING THE RIGHT TO JUDICIAL REVIEW OF AGENCY AND OWNER COMPLIANCE WITH THEIR STATUTORY AND REGULATORY OBLIGATIONS

Given the lack of compliance by owners and the lack of adequate monitoring by HUD, it is essential that Congress give the courts the power to review both the action of the owners and of the government. While Congress can periodically provide oversight hearings, it cannot ensure compliance on each individual project should HUD or the owner fail to meet the obligations imposed on them by statute or administrative regulation or agreement.

Action by Congress in this area is necessary because the United States Court of Appeals for the First Circuit in Falzarano v. United States, 607 F.2d 506 (1st Cir. 1979) has held that (1) tenants do not have the right to bring a cause

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11 The legislative history from the 1968 Senate Report, supra p.26, specifically refers to the obligation to maintain the projects as lower-income housing following foreclosure.

of action against project owners to prevent a rent increase or to obtain restitution of funds to the project even where the tenants have alleged that the owners have engaged in financial practices which are illegal and criminal and in violation of specific statutory and regulatory requirements; and (2) the tenants cannot seek judicial review of HUD's actions even where the tenants have alleged that HUD knowingly acquiesced in the illegal practices through failure to enforce the statutory and regulatory requirements governing the projects, despite specific findings by the agency that certain practices were impermissible and illegal. Under Falzarano, both HUD and the owner are thus insulated from court review. The opinion affects all projects within the jurisdiction of the First Circuit, i.e., Massachusetts, Rhode Island, Maine, New Hampshire, and Puerto Rico.

In order to ensure that government agencies administering housing programs and project owners will be monitored, Congress should enact legislation which will:

- o give all persons (both tenants and owners) residing in Government (HUD, FmHA, VA, etc.) assisted, financed, insured, or owned multifamily and single family housing the right to maintain a cause of action against the owner of such projects and the agency charged with administration of the program;12/
- o provide that the courts can review activities of the owners, and/or agencies taken pursuant to the federal housing statutes and the administrative regulations and agreements issued pursuant thereto, including, but not limited to, actions requiring the written

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12 Consideration should also be given to granting the right to maintain a private cause of action against the mortgagees for their failure to ensure that the project be maintained in compliance with the regulations and agreements governing the projects.

approval of the head of the federal agency;

- grant the right to obtain injunctive and declaratory relief, restitution, rescission, damages, and other equitable and/or legal relief; and
- grant jurisdiction in the federal courts to hear actions brought pursuant to this section.

## VII. CONCLUSION

We thank the Committee for the opportunity to make this statement. We would be happy to work with the Committee and its staff in further developing the suggestions contained in this analysis.

NATIONAL HOUSING LAW PROJECT

Ms. ROISMAN. Thank you, Senator Proxmire, Senator Leahy. The National Housing Law Project is, as Senator Proxmire said, a legal services backup center that dictates the principles that govern our perspective on low-income housing. The principles are simple. There are only two. One is that we want decent, affordable housing for low-income people and the other is we want effective, public subsidized housing programs. We want effective public programs not only because we are high-minded people and want them as a matter of principle but also because poor people cannot have decent housing except through public programs and if the public programs don't work well, then our clients are the ones who are hurt most immediately and most grievously. So no one is more concerned than our clients and we on their behalf when there is defalcation, collusion, graft, corruption, incompetence, or anything else. Any theft from a subsidized housing project is a theft from the tenants first and most immediately.

In our prepared statement, we have set out in some detail, and we hope to have the opportunity to discuss with the staff of the subcommittee in more detail a study that the Housing Law Project has conducted which indicates that the two objectives dovetail perfectly. If, instead of spending vast amounts of money on assigned mortgages, on foreclosures, and on dispositions at a loss—if instead of doing that HUD were able to provide a tenant-based subsidy that would enable low-income people to have decent, affordable housing up front, not only the tenants but the public in general would benefit because the expense would be substantially less. We do not propose to go into that in detail. It sounds too good to be true, but the study has been conducted using extraordinarily conservative estimates and if there are any holes in it, we hope that the subcommittee will ask GAO to look through it with a fine-tooth comb. But so far as we can tell, so far as people we have consulted can tell, it is literally the case that it will not only be more humane and more civilized and more cost effective in social terms to provide the decent, affordable housing in the first place, but it will in the short run cost the Government less money to do it that way.

### ADMINISTRATION OF UNITS BY HUD

Having said that, I would like to do two things. I would like to say several harsh things about HUD and how it administers the units over which it has control, but before I do that, I would like to take the relatively unusual step—unusual for a legal services lawyer who represents poor people—of saying one word of praise for HUD. And to say the word of praise I have to breach some Washington traditions. Given this is a subcommittee chaired by Senator Proxmire, I feel I am in a suitable forum for breaching Washington conventions.

I think we have to do four things if we are going to talk honestly about how HUD administers its subsidized housing program. We have to stop pretending that this HUD is the same as HUD in the previous administration. We are talking about a different political party. We are talking about a different Secretary, a different Assistant Secretary, and a different Deputy Assistant Secretary. We are talking about different institutions.

The new HUD is not what the old HUD was. They talk about it as if it is a continuing institution, but we do not have to undertake the same pretense.

### CAREER PERSONNEL AT HUD

Second, we have to recognize that there is a difference between the policy people and the career people. There are some very fine dedicated career people at HUD, but I have been representing low-income people as a legal services lawyer working in the housing field since 1967, and I can tell you that there are a lot of ineffective, incompetent, unworthy career people at HUD, and I do not like to see policy people who are trying to do a good, effective job tarred because they have to deal with the mess they have inherited.

The third convention I am going to breach is pretending the Washington office of HUD is the same as the field and area offices of HUD because it isn't. As I listened to Susan Taylor's extremely effective testimony, having had the benefit of reading some of the documentation before, one of the things that struck me was that she has been dealing with the field office. She has been dealing with Elmer Bidford in Chicago. He may be a perfectly nice man, but the legal services people in Chicago don't deal with the area office; they come to Washington and deal with the top people here. Indeed, our advice to the legal services lawyers who ask us for advice is don't talk to anyone below the level of a deputy assistant secretary, because you won't get any place.

I spoke recently to the Office of General Counsel at HUD. I was appalled to earn that there are 130 lawyers employed full time in Washington and what I said to them was, we tell legal services lawyers not to talk to anybody but the General Counsel and the Deputy General Counsel because otherwise the odds are they are wasting their time.

### COMPLAINTS AGAINST HUD AND OMB

And the last convention I want to strike down is the convention of pretending that OMB doesn't exist. Now, I am going to enter a lot of complaints against HUD. Some are in this statement and I am going to say some more. Some of them lay properly at the door of HUD, but others lay properly at the door of OMB because OMB is telling HUD that it can't spend money that the policymakers at HUD know needs to be spent.

I have breached many conventions. I have to say that Assistant Secretary Simons, who I imagine, sitting back there, is going to be stunned to hear me say something good about him, has not done everything we want him to do. There are lots more things that we think need to be done that he can do without any more from Congress or from OMB. But he has implemented an effective policy that not only helps to protect the poor people who live in the buildings, but also enhances the integrity of the programs themselves, and moving anything in that agency is like molasses.

I marvel that he and Deputy Assistant Secretary Melkonian and Deputy Assistant Secretary Clyde McHenry and other good, effective public servants who have gone to that Department have been able to accomplish anything at all.

Having said that, I am now going to complain bitterly because they haven't done more.

I began by saying that nobody is hurt worse than we are, worse than our clients are——

Senator PROXMIRE. I hesitate to say this, but you have only 2 minutes left to complete your testimony.

Ms. ROISMAN. I will talk very fast.

### ASSISTANCE TO TENANTS

I will say three things very quickly. First of all, not only should HUD recognize that tenants should be able to complain in court about how owners and HUD run these programs, but more than that, HUD's best investment would be to provide technical assistance to tenant groups so that other groups can do what FHA Tenants United from Chicago can do. You cannot do that kind of work without effective paid professional staff. I don't know where FHA Tenants United found the money to do it, but that is the best investment HUD could make.

### POLICIES OF HUD

Second, the policies that HUD has implemented that we think are very effective and good—keeping tenants' rents to 25 percent of income, preventing displacement to a certain extent, repairing buildings, saying no disposition of units occupied by low-income people without a subsidy—each of those needs to be taken further. They are not repairing nearly enough buildings. Each of those needs to be taken further.

### UNSUBSIDIZED MULTIFAMILY PROJECTS

Finally, and most important, there is an enormous inventory of publicly financed units that isn't being talked about yet and isn't being dealt with by HUD. They are the so-called unsubsidized multifamily projects. They are not truly unsubsidized. A 3-percent mortgage is not an unsubsidized project. They are the 608's, World War II veterans housing, 207's, 231's. There are hundreds of thousands of units out in the inventory and HUD is doing absolutely—well, I think that HUD is doing almost absolutely nothing to take those publicly financed units that were built for a public purpose and making sure that they are permitted to continue to serve a public purpose and I will give you, Senator Proxmire, four specific examples and then I will shut up.

### ROBINHOOD APARTMENTS

First, Robinhood Apartments in Norfolk, Va. Section 207 housing, 1,500 units, of which 1,400 are occupied.

The project cannot be sold without HUD approval. Despite that fact, there is a contract of sale between the owner and the city of Norfolk that calls for the units to be sold starting May 1, so that the city of Norfolk can demolish them. It's an integrated project. It is probably the only integrated project in the entire city of Norfolk, Va., and the city is going to tear it down.

### RIVERVIEW APARTMENTS

A project in Alexandria is Riverview. It is 240 units of World War II veterans housing and the city of Alexandria is tearing it down to build higher income housing. Given GAO's recent report on the crisis of rental housing, how can HUD let these projects be torn down?

### GARFIELD HILL AND BASS CIRCLE PROJECTS

The two projects in the District of Columbia are Garfield Hill and Bass Circle. They were built for World War II veterans. World War II veterans' children and widows are still living in those projects. HUD, so far as I can tell, is standing by and letting those units be converted to higher income use when it ought to be reaching out to protect them and keep them to serve a public purpose.

Senator Proxmire. Thank you very much, Ms. Roisman.

Senator Leahy has pointed out the delightful irony of the name of the first apartment complex you mentioned, the Robinhood Apartments.

Ms. Roisman. Senator Leahy is not alone in that, but I am very glad he picked that out.

### RIGHTS OF JUDICIAL REVIEW

Senator Proxmire. Toward the end of your prepared statement you outline a number of steps the Congress should take to create the right to judicial review of agency and owner compliance with their statutory and regulatory obligations. Your concerns are essentially derived from the recent first circuit court of appeals decision on *Falzarano* v. *United States* which said, among other things, that tenants do not have the power to require HUD to enforce its own regulations.

That decision appears to deal a rather serious blow to the tenants' ability to blow the whistle on alleged illegal practices by owners of projects and to seek judicial review of the Department's actions in enforcing the statutory and regulatory requirements governing the projects.

Although this particular decision affects projects with the jurisdiction of the first circuit, what, in your estimation, would be the broad, national implications of this particular decision on the tenants' ability to bring a cause of action against both unscrupulous owners and HUD?

Ms. ROISMAN. Senator, I wouldn't want to say we want Congress to create the right to judicial review because it is our position the right exists and the first circuit decision is just plain wrong.

My personal judgment is it is incredibly wrong. As between my judgment and the decision of the U.S. court of appeals for the first circuit, other Federal courts are far more likely to heed what the first circuit has done. And the very best to which we can look forward is that we will have to litigate that issue in every other circuit in the country.

### LEGISLATIVE REMEDY

Senator PROXMIRE. I think maybe we can give you some kind of legislative remedy. I don't think we have to have a law passed. I think we can do that with language in a committee report.

Ms. ROISMAN. I think, Senator, that that will be very helpful. A key element in the court's decision on that issue is what is the intention of Congress? Did Congress intend that there should be judicial review and that the tenants should be able to do this?

My reading of legislative history is that certainly was the intent and clarification would be very welcomed.

### LONG-TERM SUBSIDY PROGRAM

Senator PROXMIRE. One of the legislative proposals that your organization suggests to help prevent assignments and to preserve the low- and moderate-income character of multifamily housing projects is the so-called long-term moderate tenant-based subsidy program which would fix tenants' rents at 25 percent of income, including utilities, over the life of the project mortgage or the remaining life of the buildings, whichever is greater. On page 15 of your testimony you outline the percentage savings your proposal would have over the current costs incurred when a property is assigned, foreclosed upon, and then resold. However, you do not provide information on the overall annual cost of that approach.

I know that you may not be in a position to go into great detail, but do you have some idea of the annual budget authority required to implement this subsidy program if it were to be enacted in fiscal year 1981, for example? Ms. Cohen?

Ms. COHEN. I have the overall cost. What we did was a comparison between what it would cost to prevent assignment and foreclosure versus letting projects go into the HUD inventory. We found it would be far cheaper for the Government to prevent assignment by providing a tenant-based subsidy than to carry the cost of assignment where the Government has to pay the full mortgage claim.

### ROBINHOOD APARTMENTS

Senator PROXMIRE. Ms. Roisman, to get back to the Robinhood Apartments complex for just a minute, you mentioned in your oral testimony that you are urging HUD to turn down a deal in Norfolk, Va., that would allow the city of Norfolk to purchase a 1,500-unit HUD-insured project, with 1,400 occupied dwellings, and tear down the complex. You also mention two projects in the District of Columbia—both HUD-insured—that are in good condition, but being considered for conversion to condominiums.

### LOW-INCOME HOUSING

What specific tools does HUD have at its disposal to deal with situations such as these where the availability of low-income rental housing is in jeopardy?

Ms. ROISMAN. In the case of the World War II housing, Senator, and that is the two projects in the District of Columbia and the project in Alexandria, HUD is a part owner of those projects.

HUD holds all the preferred stock in the corporation that owns those projects. These are projects that were financed in 1948 and 1949 and the control HUD was given is embodied in the charter. The provision was that the private entrepreneurs would hold the common stock and the FHA Commissioner would hold all the preferred stock. HUD has total control over those corporate entities.

In the case of any default, not just the financial default, but a failure to keep the property in good condition, a failure to provide annual certified financial reports, any kind of default at all, HUD can remove the directors of the corporation and replace them with its own nominees.

Now, that is authority that HUD exercised in some cases 15 years ago when projects went into financial default, and our position is that when the projects go into nonfinancial default, when the annual certified financial statements are not filed, when the projects are permitted to deteriorate physically, HUD ought to then step in and exercise its authority to take over those projects and preserve them for public use.

### GARFIELD HILL APARTMENTS

What happened in Garfield Hill is that about a third of the tenants there are black World War II veterans, men who saw active duty in the U.S. Army, Navy, Air Force in the Second World War. They came home. Some of them worked for the contractor who built that project. Then they moved in and lived there for 30 years, from 1948 and 1949 until a year or year-and-a-half ago. They raised their families there. Some of them retired and then they were evicted by the private owner from a project in which HUD owns all the preferred stock and HUD unquestionably had the power to prevent any of that from happening.

Senator PROXMIRE. Senator Leahy?

Senator LEAHY. No questions, Mr. Chairman.

In fact, I am going to have to leave.

### PROBLEMS TO EFFECT CHANGES

I know Senator Mathias has some questions for GAO and HUD. I am glad, however, that the witness pointed out a matter of concern for all of us. I commend you for having this hearing. I think it is extremely important.

I was pleased, also, that she pointed out praise for Secretary Simons and others because, since being on this subcommittee and hearing about the problems of HUD, what I have learned is that anybody who has been put in the position of trying to change things there is faced with an almost insurmountable backlog of problems. I hope everyone doesn't get overwhelmed by it and throw up their hands and say, "Nothing can be done." I hope everyone doesn't become overly defensive when problems are pointed out.

Secretary Simons' testimony points out that HUD has become the largest real estate dealer or entrepreneur in the world by far. Obviously you are going to have some problems.

I am glad, ma'am, that you are pointing out the problems and that you have also pointed out some areas where positive steps have been taken. I think such steps have been taken. When we jump on the bureaucracy or anything else, I think it is wise to also point out areas where improvements have been made so that we can continue funding and encouragement in those areas, just as we should point out problem areas. I think, quite frankly, the best way to solve a lot of these problems is more and more to put the faces and names of people together who make the ultimate decisions.

Generally there is no name or face. We vote, a hundred of us vote. When we vote, that is a matter of public record. By the same token, we should know who does what, and so forth.

### DECISIONMAKING

Ms. ROISMAN. I think that is right. I was encouraged when Senator Proxmire held the last hearings on this subject that he began to do that and questioned some of the people who are not at the Deputy Assistant Secretary level, the staff people who really are responsible for setting up the situation that makes a decision or nondecision inevitable.

A few of them were called to testify and I think it would be healthy to do more of that instead of having the people in the highest positions be good soldiers and take the responsibility for everything that the staff people have done even when the staff people are people they have inherited over whom they have almost no control.

Senator LEAHY. From the dealings I have had so oftentimes with the heads of divisions on the assistant secretary level, I have been extremely impressed with their diligence. I think I put in long hours. But I look at the hours they put in and the concern they have for individuals, the fact that they are not just dealing with what are the numbers of units, but the people.

I have seen it in my own State of Vermont when they have traveled there and have looked at it and said, "What does it mean in a rural setting? What are you really doing?" I am impressed with with a concern toward individual people. I hope these hearings will serve as kind of a catalyst so that that concern will work its way all the way down.

I hope a lot of those people are listening.

That is my whole speech for the day.

Senator PROXMIRE. I appreciate that and I certainly wholeheartedly agree that people like Assistant Secretary Simons, Assistant Secretary Embry, and others in the Department are topflight people. I have great admiration and respect for them. The fact is, however, that the results are bad and, as the previous witness pointed out, and there have been no improvements in some of these areas for 2½ years.

I am not satisfied with the notion that there is a dead bureaucracy out there that you can't move. They can be moved, and you ought to come up and tell us to get rid of some of them.

### GENERAL COUNSEL'S STAFF

You pointed out that there are 130 lawyers in HUD's central office. We ought to get rid of half of them. Apparently they are not doing anything out there.

I think we have to shake things up. I think you are correct in saying that the top-level administrators who have come in are an improvement on the past. It is impossible to go the other way in view of——

Ms. ROISMAN. I would like to be right there with you when you try to trim the size of the General Counsel's staff, since what they seem to be doing is arguing that tenants don't have any right to go into court to challenge landlords' actions or inactions.

Senator LEAHY. It sounds like they have more lawyers than people.

Senator PROXMIRE. That is about right.

Ms. ROISMAN. I do want to say that I find the testimony of FHA Tenants United as shocking as everyone here does.

I know of many other situations that are like that, including the situations I have mentioned.

### ACTIONS BY HUD

I also know there are cases where HUD has acted. I have to think those are the cases in which the matters have been brought to the personal attention of either Secretary Simons or one of his deputies or special assistants. That is no way to run a Government. But I think they are in the record.

Senator PROXMIRE. You and Ms. Taylor agree, apparently, that if you are going to get action, you have to go to the top.

Ms. ROISMAN. You have to go to the top. There are tenants groups and legal services lawyers who have written to you and the subcommittee to tell of situations in which HUD has responded, albeit——

Senator PROXMIRE. Maybe you can go to the top. President Carter has always said to call him up anytime. He is waiting there for calls. He has encouraged everybody to do it in and out of Congress.

Thank you very much.

# GENERAL ACCOUNTING OFFICE

## STATEMENT OF D. L. SCANTLEBURY, DIRECTOR, FINANCIAL AND GENERAL MANAGEMENT STUDIES DIVISION, GENERAL ACCOUNTING OFFICE

## ACCOMPANIED BY JOHN J. CRONIN, GENERAL ACCOUNTING OFFICE

### HUD MULTIFAMILY INVENTORY

Senator PROXMIRE. Our next witness this morning is Mr. D. L. Scantlebury, Director of the Financial and General Management Studies Division of the General Accounting Office Mr. Scantlebury will be accompanied by four of his assistants who have worked on GAO's review of HUD's accounting system for Secretary-held multifamily mortgages.

Gentlemen, I appreciate the effort you have all put into this report, especially in view of the rather short time frame within which you had to work. I appreciate your bringing charts with you so you can make your presentation as clear as possible.

I want to particularly thank John Cronin and his staff for the fine detailed work they did in looking at the day-to-day operations of HUD's accounting system as well as Keith Fultz and his staff for their report on the condition of HUD's multifamily inventory.

### PREPARED STATEMENT

Mr. Scantlebury, go right ahead. I would appreciate it if you, too, could confine your remarks to 10 minutes. If there is anything you have failed to cover, you can make additional remarks after our questioning. Your entire statement will be printed in full in the record.

[The statement follows:]

## STATEMENT OF D. L. SCANTLEBURY, DIRECTOR, FINANCIAL AND GENERAL MANAGEMENT STUDIES, GENERAL ACCOUNTING OFFICE

Mr. Chairman and Members of the Subcommittee:

We are here today at your request to discuss our review of the Department of Housing and Urban Development's (HUD's) accounting system for Secretary-held multifamily mortgages. With me today are Mr. John Cronin, Senior Group Director of our Financial and General Management Studies Division, Mr. James Curry of his staff, Mr. Sam Piscitell of our New York Regional Office, and Mr. Keith Fultz of our Community and Economic Development Division.

Over the years, we have reported and testified on many deficiencies in HUD's accounting systems. We first reported on accounting weaknesses in 1975 when we examined HUD's system for the payment of taxes on HUD-owned property. At that time, HUD informed us of its plans to institute a highly automated system, termed "HUDMAP," which was to be the solution to most of its system problems. Since then, HUD has continued to cite the still forthcoming HUDMAP system as the answer to many problems identified in our reviews and currently plans to have the multifamily phase of HUDMAP operational by October 1981. The new system should address itself to many of the current system problems. We believe, however, that since the planned implementation of the multifamily HUDMAP phase is still almost 2 years away, interim changes must be made to the current system to correct some of the problems we will be discussing today.

Before discussing the results of our current review I would like Mr. John Cronin to present an overview of the accounting and servicing systems for Secretary-held multifamily mortgages.

We acknowledge that HUD's management and servicing of assigned multifamily mortgages is a difficult and formidable task. When assigned, the projects already have a history of financial and/or management problems. However, while we recognize these difficulties, our analysis of the current inventory indicates that HUD can improve the management of its multifamily inventory.

As of September 30, 1979, HUD held 2,034 project mortgages valued at approximately $3.7 billion. About 71 percent, or 1,442, of these projects were delinquent in their mortgage payments. The total amount of those delinquencies, according to records in HUD's Office of Finance and Accounting, was about $500 million, of which about $325 million was owed for accrued interest delinquencies. The 1,442 delinquent mortgages were classified as follows:

| | |
|---|---|
| No current workout agreement | 696 |
| Under current workout agreement | 382 |
| In foreclosure process | 364 |

As shown above, 696 of the financially troubled projects did not have current workout agreements and were not in foreclosure. We found no evidence that many of those mortgages had ever been placed under a workout agreement. Others had been under workout agreements which expired many years ago.

During the period owners are delinquent in their mortgage payments and while foreclosure on mortgages is in process, Internal Revenue Service (IRS) officials said the project owners can claim income tax deductions for accrual of unpaid interest and depreciation expenses. Justice, HUD, and IRS officials acknowledged that owners often contest foreclosure actions to extend the period of time in which they can benefit from accrued interest and depreciation deductions on their Federal income tax returns.

As of September 30, 1979, the total accrued interest delinquency on HUD-held multifamily mortgages was about $325 million. Since about three-fourths of these projects are owned by profit-motivated mortgagors, substantial income tax revenues could be lost to the Federal Government because deductions are allowed for expenses which are not actually paid. That part of the accrued interest delinquencies, which may eventually be paid by project owners, will not result in lost tax revenues. However, for many mortgages which are seriously delinquent and those in foreclosure, the likelihood of accrued interest ever being paid to HUD is small. These and other matters are discussed in a CED report issued to the Chairman, January 16, 1980. (CED 80-43)

## CURRENT SYSTEM PROVIDES INADEQUATE COLLECTION INFORMATION TO SERVICERS IN THE FIELD OFFICES

HUD's accounting system for Secretary-held project mortgages, which provides monthly payment and billing data to the mortgagors and the HUD field offices, does not provide servicing personnel with sufficient information to aggressively service their workload. More specifically, we noted that:

--The monthly bills were based on the payment terms of the original mortgages and did not reflect the status of the accounts under workout agreements, which provide for reduced payments.

--The monthly bills were generally received by the loan servicers in the area offices after the due date of the monthly payment shown on the bill, thus making aggressive servicing of troubled projects difficult.

--Interim billing procedures did not exist for newly assigned mortgages, resulting in delayed initial billing.

--The lack of inventory controls caused some bills to go to the wrong field offices.

--Adequate incentives did not exist to encourage mortgagors to make payments by the due date.

--The accounting system did not provide annual account statements or produce sufficient delinquency data.

--The system had no effective mechanism to reconcile the tax status of the properties with the records of the local taxing authorities.

## ACCOUNTING SYSTEM DOES NOT TRACK PAYMENT STATUS UNDER TERMS OF WORKOUT AGREEMENTS

Once a defaulted mortgage is assigned, the HUD field office should determine if the mortgage can be brought current or if it should be foreclosed. If reinstatement is possible, a new payment agreement, called a workout agreement, should be negotiated. After entering into a workout agreement, the HUD servicer must know if the mortgagor meets the workout agreement's terms. Under HUD's current system, the bills continue to be based on the terms of the original mortgage and do not reflect the payment status under the workout agreement, a copy of which is on file at headquarters. As such, performance under the workout agreement cannot be easily determined.

Even though the payment status under the workout agreement can be determined with this system, the time required is not a good use of resources. Only by reviewing each bill in detail, or by maintaining a local payment history and then comparing that history to the terms of the workout agreement, could a servicer determine the payment status. Several servicers in HUD's New York field office stated they did not know the payment status of the cases they serviced or gave us incorrect information when we asked for the payment status.

In San Francisco we found that the HUD field office, contrary to the HUD procedures for centralized payment, was receiving payments locally for most of its inventory of Secretary-held multifamily mortgages. This practice enabled the field office to develop its own payment histories and aggressively service its inventory.

We believe that the Department should provide servicing personnel with information that reports mortgagors' payment status under the terms of the workout agreements. This information would simplify the servicing efforts of the field office personnel. However, to determine the payment status of the mortgages under the workout agreements, all workout agreements should specify a minimum payment amount due. We found in the past that not all workout agreements specified a payment amount. Some New York workout agreements called only for cash remaining after the payment of reasonable and necessary operating expenses. Therefore, mortgagors submitting no payments could be current under their workout agreements.

## MONTHLY BILLS RECEIVED IN HUD FIELD OFFICES LATE

In both field offices we visited, personnel complained that the monthly bills sent from the Department's Office of Finance and Accounting in Washington, were generally received late and were of limited use in servicing the projects. During our review, we noticed the following examples:

--The June 1979 monthly bills for the New York field office, which showed both the amount due June 1, 1979, and the payments received in May 1979, were received by the servicers in the New York field office on July 2, 1979, over a month late.

--The September 1979 monthly bills for the San Francisco field office, which reflected both the amounts due September 1, 1979, and the amounts paid in August 1979, were received in HUD's San Francisco field office on September 17, 1979, at least 17 days late.

--Some monthly bills were sent to the wrong field offices. For example, in May 1979 the New York field office received bills for six projects not serviced by it.

Aggressive servicing is not possible when field offices do not get timely payment data. We believe the monthly bills should be in the hands of the servicers by the due date of the payments. In addition, collection data should be transmitted to field offices shortly after payments are received.

## LATE FIRST BILLS ON NEWLY ASSIGNED SECRETARY-HELD MORTGAGES

HUD is responsible for aggressively servicing newly assigned mortgages and impressing upon mortgagors their obligation to make full mortgage payments to HUD. However, we found that delays were occurring in billing newly assigned mortgagors.

We selected 26 of the 126 New York projects and 12 of the 49 San Francisco projects for further review. Our review revealed that for the New York projects, the Office of Finance and Accounting took an average of 4.6 months from the date of assignment to the first bill. The range was from 1 to 16 months. The average for the San Francisco projects was 2.8 months, with a range of 1.5 to 5 months.

After assigning a defaulted mortgage to HUD, the original lender has 45 days to file for payment of the insurance claim. The Office of Finance and Accounting was not preparing the first bill until the necessary documents were received. Since some claims are not filed on time, or are filed with incomplete information, the Office of Finance and Accounting often took many months to prepare the first bill. Therefore, the servicer did not know the status of the account. We believe interim billing procedures should be implemented to ensure that once the notice of assignment is received, the mortgagor is immediately billed for the normal payment due under the mortgage.

## SYSTEM DOES NOT PROVIDE ADEQUATE PENALTIES FOR LATE PAYMENTS

HUD does not provide adequate incentives to mortgagors to make their payments by the due date. At the time of our review, late penalties were only assessed on mortgagors who were current under their mortgage terms and who made a late payment. Since the majority of the Secretary-held mortgages are delinquent under the mortgage terms, few late penalties are actually assessed. Late charges could not be assessed on delinquent mortgagors because the accounting system did not track compliance with the payment terms of workout agreements.

We believe that late penalties should be assessed either on the minimum payment specified in the workout agreements, or when workout agreements are not in effect, on the payment due under the mortgage. HUD officials informed us that they are considering revising their late-charge policy.

## BETTER CONTROLS NEEDED TO RECONCILE RECORDS OF TAXING AUTHORITIES WITH HUD RECORDS

Taxes on Secretary-held multifamily mortgages are paid centrally from HUD's Office of Finance and Accounting in Washington. In the past, we have reported on a number of problems with centralized tax payment systems. Subsequent to our 1975 report to the Congress entitled "Action Being Taken to Correct Weaknesses in the System of Paying Taxes on Acquired Residential Properties," HUD assigned the responsibility for the tax payment function for acquired single-family property to the field offices.

In addition to that decentralization, HUD recently changed its procedures for tax payments on Secretary-held, single-family mortgages by requiring field offices to obtain all tax bills, post them to local records, and forward the bills to Washington for payment. However, the tax payments for the multifamily projects remained centralized.

To determine the tax status of the New York Secretary-held project mortgages, we reviewed 26 selected projects at the taxing authorities in the cities of New York and Yonkers. Numerous under- and overpayments were reflected on the records of the taxing authorities:

--Eight of the 26 projects owed delinquent real estate taxes totaling $39,883.

--$111,427 was owed to the projects or HUD for overpayments of real estate taxes on nine projects.

--Nine projects owed delinquent water and sewer charges of $41,003.

--$16,983 was owed to the projects or HUD for overpayments of water and sewer charges on nine projects.

--$33,182 had been paid on 14 projects for interest and penalties on delinquent taxes.

We found one project which HUD listed as exempt from taxes, but according to taxing authority records it was exempt only from real estate taxes and not water and sewer charges. Because the water and sewer charges on this project had not been paid for 4 years, the city of New York had started action to take over the property for nonpayment.

New York City taxing authorities said that overpayments of taxes are not netted against underpayments, and overpayments are refunded only if the overpaying party submits a claim for refund and proves the overpayment was made. Furthermore, there is a 6-year statute of limitations on refunding overpayments. Therefore, if the refund is not applied for within 6 years of the overpayment, the city of New York retains the funds. These problems point out a need for HUD and taxing authority records to be reconciled periodically. We believe these reconciliations can best be performed from the HUD field offices where a fewer number of different taxing authorities need to be dealt with and where visits to the taxing authorities to periodically reconcile records are feasible.

To correct the problems noted, we recommend the Department

--provide servicing personnel with information that reports mortgagors' payment status under the terms of workout agreements.

--establish an interim billing system for newly assigned mortgages,

--assess late charges on payments due under the mortgages or the workout agreements,

--require periodic inventory reconciliations,

--decentralize to field offices the responsibility to obtain tax bills, and

--require periodic reconciliations between the records of HUD and the taxing authorities.

## MAJOR IMPROVEMENTS NEEDED IN SERVICING AT HUD'S NEW YORK FIELD OFFICE

We selected at random 26 of the 126 multifamily projects for detailed analysis at HUD's New York field office. On May 1, 1979, the 26 projects were in the following status:

--Five projects had never been under a workout agreement since assignment even though they were assigned as far back as 1975.

--Nine projects had expired workout agreements but were still delinquent.

--Two projects were serviced under an informal agreement (no written agreement existed).

--Ten projects were either under a permanent modification agreement, a current workout agreement, or had been recommended for foreclosure.

We determined the change in delinquency status under the mortgages for the 26 projects from the date of assignment to May 1, 1979. Of the 26 projects:

--Four, or 15 percent, showed some decrease in the number of months delinquent.

--Twenty-two, or 85 percent, showed an increase in delinquency since assignment. Seven of the 22 were recommended for foreclosure, however, of the remaining 15, nine increased the amount of their delinquency under the mortgages by 12 or more mortgage payments and four increased their delinquency rate under the mortgages by over 3 years.

## SOME DELINQUENT MORTGAGORS HAVE NEVER HAD A WORKOUT AGREEMENT

Five of the 26 New York projects we reviewed had never been under any workout agreements even though two of the five had been assigned as far back as February 1975. As of May 1979, these two projects were delinquent $840,505 and $909,347, and both had increased their delinquencies by 49 months since assignment. We were recently informed that these two projects have been recommended for foreclosure.

## FINANCIAL ANALYSIS IS LIMITED AND REQUIRES IMPROVEMENT

HUD requires that annual financial reports for each project be prepared in accordance with the requirements of the Secretary. These statements are due within 60 days after the end of each fiscal year and are certified to be accurate by both an independent public accountant and an officer of the mortgagor. Upon receipt of financial statements from mortgagors, HUD requires a timely review and evaluation of the statements to determine their completeness and accuracy.

HUD's audit guide sets forth standards to be followed by independent public accountants in conducting audits of multifamily mortgagors whose mortgages are or have been insured by HUD. The audit guide must be followed by independent public accountants in performing audits of projects with a fiscal year ending on or after December 31, 1978.

The audit guide also requires that the independent public accountants conducting the audits will have to judge the propriety of project disbursements. Their judgment is important because HUD has no precise definition of expenses reasonable and necessary to the operation and maintanence of the projects.

As provided for in HUD regulations, delinquent mortgagors are required to submit monthly accountings showing cash receipts and disbursements. HUD considers those monthly reports to be essential to monitoring multifamily projects at such critical times as when a project is in default. These reports provide basic data and, since they show all cash receipts and disbursements during the previous month and cash on hand at the end of the month, they should be carefully reviewed shortly after receipt.

A followup system is required to assure that the monthly reports are received promptly. Reports are due by the 10th of the month. Failure to submit the required accountings is contrary to the regulatory agreement. If the mortgage is under an approved workout agreement, failure to submit the reports is not in compliance with the terms of this agreement.

### Review of specific items in the monthly and annual financial statements

The required reviews of monthly and annual financial statements must be made promptly, and questionable items must be investigated. However, we found that these reviews were not always being made.

Our analysis of 11 financial statements for New York projects, which reported on periods covered by the audit guide, revealed that none of the 11 statements fully complied with the requirements in the guide. All 11 statements were missing one or more of the statements or the supporting data required by HUD. In addition, eight of these projects did not submit their statements within the required 60 days and in no cases did the independent public accountants question any expenses of the projects as unreasonable and/or unnecessary.

A review of the files of these 11 projects revealed only two instances where the mortgagor was requested to submit revised financial statements to conform to the new audit guide requirements. We found that the revised statements for one of the two projects were still incomplete at the time of our review and had not been reviewed by the responsible servicers. The other project had not submitted revised statements.

Our review of the monthly accountings submitted for the 26 New York projects for January through June 1979 revealed

- --no evidence that eight of the 26 projects had their monthly statements reviewed,
- --failures to submit reports and HUD's failure to request such delinquent reports.
- --various expenditures which needed further clarification,
- --unsigned reports, and
- --late receipt of reports.

In discussing our findings with field office officials, they admitted that their analysis of financial information did not conform to HUD requirements. They stated that servicing personnel do not have the financial background to adequately review financial information.

We feel this failure to receive and/or review required financial information is a serious breakdown in HUD's internal control system and creates a situation where project receipts can be easily diverted.

Similar problems previously reported

In the past, both the GAO and the HUD Inspector General have reported on problems similar to those we found in New York. In a March 1979 report prepared by the HUD New York Regional Inspector General for Audit, New York's servicing of HUD-insured and HUD-held mortgages was found to be inadequate. According to the report, because financial statements and monthly accounting reports are not reviewed, the branch failed to detect

- --possible diversions of project funds,
- --excessive management fees and improper Section 8 application fees,
- --questionable withdrawals of project funds while the mortgage was in default, and
- --improperly executed workout agreements not in accordance with HUD regulations.

In addition, in a December 11, 1979, summary audit report to the Assistant Secretary for Housing, the Inspector General summarized the audit findings of 82 audit reports covering 93 insured and HUD-held projects for the 12 months ending June 30, 1979. The report identified a total of about $12.3 million of project funds questioned or disallowed in these 82 audit reports. Of the $12.3 million, $7.8 million was attributed to the improper or questionable use of operating revenues by 72 of the 93 projects reviewed.

Also, in a November 20, 1979, report to the Chairman, Senate Committee on Appropriations, the Committee's investigative staff identified problems with loan servicing. This review was performed at HUD's field offices in Washington, Boston, Chicago, Detroit, and Los Angeles.

As mentioned earlier, our analysis of monthly and annual financial statements raised a number of questions on the appropriateness of expenditures and on whether all receipts are properly accounted for. In cases where all receipts are not credited to HUD projects or where improper expenditures are charged to projects, funds that could have been used to make payments to HUD can be diverted to the owners and/or managing agents.

Let me give you some facts about two of the cases we examined.

In the first case, the independent public accountant's reports on the projects showed that between 1974 and 1978, the mortgagor had distributed $1.6 million to its partners and had loaned another company $1.1 million. This was done despite section 17152-4 of title 12, United States Code, which prohibits the use of project funds for other than necessary operating expenses. Because HUD's New York field office did not adequately review the financial statements for 1974 through 1978 until 1979, these problems were not discovered for almost 5 years.

Our own review work showed expenses charged to the projects which we believe should have been charged to the management fee paid the mortgagor's managing agent. These included annual charges of approximately $3,000 for Christmas parties and $9,300 for the salary of a rental agent. We understand negotiations are in process to both enter into a workout agreement and obtain the return of the $2.7 million.

At the other managing agent, we identified charges to projects which also appeared should have been charged to the managing agent's fees. These charges included telephone expenses (for one project such expenses were $5,000 in 1 year), association dues, and other administrative expenses.

Our work was greatly hampered by the fact that neither of these two mortgagors had complied with HUD regulations which specify separate cash accounts for each project. Instead, the managing agents have commingled HUD project funds with other funds which makes auditing difficult and makes it difficult to tell whether funds have been used in unauthorized ways.

These problems are not new. In a March 1974 GAO report to the House Committee on Government Operations we identified many of the same problems we are discussing here today. The recommendation for increased monitoring by HUD we are making today was also made in the 1974 report. The recommendation is being repeated because adequate corrective action was not taken by HUD in response to our 1974 report, and testimony before the House Committee on Government Operations where HUD officials cited corrective actions in process.

To improve HUD's mortgage servicing efforts, we are recommending that the Department:

--Establish workout agreements within 90 days after assignment that provide for a specific payment amount.

--Require field offices to follow up and obtain adequate financial statements when statements are not submitted promptly or fail to meet HUD regulations.

--Provide for additional training of servicers in financial statement analysis.

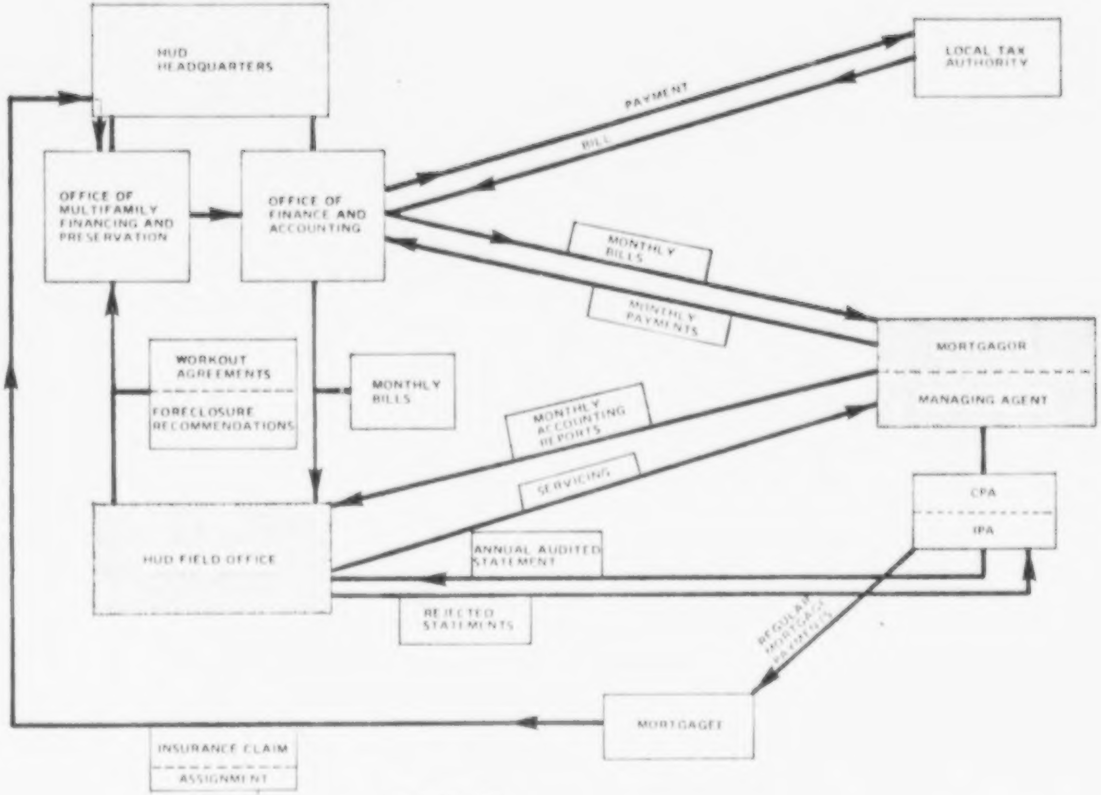
--Require aggressive action to obtain repayment of project funds that have been diverted.

## CONCLUSION

Considering the disclosures that we have made here today, and disclosures in the recent Inspector General summary audit report which reported on what appeared to be sizable diversions of project funds, as well as the recent report of the Appropriations Committee's investigative staff which reported similar problems, we believe that the problems with HUD's multifamily Secretary-held program are serious and widespread.

We have discussed our findings with HUD officials and they have advised us of a number of actions they are taking or plan to take. These actions, as explained to us, appear to be responsive to the recommendations we have made in this statement. However, many of these deficiencies have been reported before, in some cases several years ago, and the actions taken then did not solve the problems. Consequently, the Subcommittee may wish to ask HUD to periodically report on the status of corrective actions and their effectiveness in correcting these problems.

This concludes my statement, Mr. Chairman. We would be pleased to answer any questions you or other Members of the Subcommittee may have.


HUD HEADQUARTERS
OFFICE OF MULTIFAMILY FINANCING AND PRESERVATION
OFFICE OF FINANCE AND ACCOUNTING
LOCAL TAX AUTHORITY
PAYMENT
BILL
MONTHLY BILLS
MONTHLY PAYMENTS
MORTGAGOR
MANAGING AGENT
WORKOUT AGREEMENTS
FORECLOSURE RECOMMENDATIONS
MONTHLY BILLS
MONTHLY ACCOUNTING REPORTS
SERVICING
CPA
IPA
HUD FIELD OFFICE
ANNUAL AUDITED STATEMENT
REJECTED STATEMENTS
REGULAR MORTGAGE PAYMENTS
MORTGAGEE
INSURANCE CLAIM
ASSIGNMENT

JAN 1 6 1980

B-197141

The Honorable William Proxmire, Chairman
Subcommittee on HUD-Independent Agencies
Committee on Appropriations
United States Senate

Dear Mr. Chairman:

Subject: Analysis of Multifamily Assigned Mortgages (CED-80-43)

During hearings on the Clifton Terrace Project before your subcommittee on November 13, 1979, you asked the General Accounting Office to analyze the Department of Housing and Urban Development's (HUD's) inventory of multifamily mortgages to identify other mortgages which could be in severe financial difficulty. In response to this request, and based on subsequent discussions with your office, we have obtained information on

--the amount of money involved in delinquencies on mortgages held by HUD and how long the mortgages had been delinquent;

--mortgages which are currently under workout arrangements designed to bring the mortgages current; and

--mortgages which are currently in the foreclosure process, the difficulties in bringing a mortgage to foreclosure, and the length of time involved in foreclosing.

The information presented in this report was gathered from several different offices within HUD. Some of the data in the records and reports we examined was inconsistent. We had difficulty reconciling the various HUD statistics and categories of the multifamily-assigned inventory. Although we were unable to reconcile completely the number of mortgages in each category, we are confident that the discrepancies represent a small percentage of the total inventory and thus should not significantly alter our overall findings and conclusions.

HUD's management and servicing of assigned multifamily mortgages is a difficult and formidable task because, when assigned, the projects already have a history of financial and/or management problems. While we recognize these difficulties, our analysis of the current inventory indicates that improvements can be made in HUD's management of its multifamily inventory. Seriously delinquent mortgages were neither in foreclosure nor under current workout arrangements. When a project does go to foreclosure, it takes about 2-1/2 years to complete. HUD's slow actions (workout arrangements and/or foreclosures) affect both the mortgage insurance funds and tenants living in these projects because the projects often deteriorate after the owners realize that foreclosure will likely occur. In addition, certain Federal income tax benefits are available to project owners even when they are delinquent in their mortgage payments or while foreclosure is in process. Because these tax benefits are based on expenses which in many instances are not actually paid, more effective monitoring is needed to recapture these benefits after HUD acquires the projects.

Past experience has shown that at the time of mortgage assignment, action to either expeditiously foreclose on the mortgage or vigorously monitor its reinstatement could save millions of dollars for the Federal Government as well as protect the interests of the tenants these projects were built to serve.

## DELINQUENCY OF MORTGAGES

Many mortgages are so delinquent that the possibility of reinstatement is highly unlikely. As of September 30, 1979, HUD held 2,032 mortgages with a balance of approximately $3.7 billion. About 71 percent, or 1,442, of these projects were delinquent in their mortgage payments. The total amount of those delinquencies, according to records in HUD's Office of Finance and Accounting, was about $500 million. The records showed the current status of the mortgages assigned to HUD as of September 30, 1979, as follows:

| Category | Number of mortgages | Percent |
|---|---|---|
| Current | a/ 590 | 29 |
| Delinquent | 1,442 | 71 |
| Total | 2,032 | 100 |

a/HUD's Office of Multifamily Financing and Preservation records indicated that 732 projects were current. This difference is due to the fact that the finance office considers a project delinquent if payment is not received when due; however, the financing and preservation office does not consider the project in default until the second month's payment is delinquent.

Following is a breakout of the 1,442 delinquent mortgages.

| Category | Number of mortgages | Percent |
|---|---|---|
| In foreclosure process | 364 | 25 |
| With current workout arrangement | 382 | 27 |
| Not in foreclosure process, without current workout arrangement | a/ 696 | 48 |
| Total | 1,442 | 100 |

a/HUD officials told us that about 150 of these mortgages are less than 2 months delinquent and thus do not yet require a workout arrangement.

Of the 1,442 delinquent mortgages, 514, or 36 percent, are more than 2 years behind in their mortgage payments and, of these, 126 are more than 4 years late in their payments.

Twelve of the mortgages that are over 4 years delinquent are neither under a current workout arrangement nor in foreclosure. These 12 mortgages have a total delinquency of $17 million. (See enc. I.)

According to HUD officials, one historical method of estimating whether a delinquent mortgage can be brought current involves determining the degree of delinquency in accrued interest as a percentage of principal balance. According to these officials, if accrued interest delinquency on a mortgage exceeds more than 10 percent of its current outstanding principal balance, the probability of the mortgage becoming current is questionable. HUD officials stated that there are other factors which should be considered in evaluating whether or not a mortgage can be brought current, such as compliance with regulatory agreements and/or workout arrangements, the quality of project management, and the physical condition of the project. While the 10 percent criteria should not be the sole determinant in foreclosure decisions, mortgages exceeding this criteria should be closely monitored.

Using this criteria, we calculated the degree of delinquency in accrued interest as a percentage of outstanding principal balance as of September 30, 1979, for the 1,442 delinquent mortgages. We found that 538 mortgages, or about 37 percent, exceeded the 10 percent criteria; 188 of these projects were delinquent by 20 percent or more. Several of these mortgages exceeding the 10 percent criteria were not in foreclosure nor under current workout arrangement. (See enc. I.)

## USE OF WORKOUT ARRANGEMENTS

A workout arrangement is one tool available to HUD to attempt to reinstate delinquent mortgages to current status. It is a written agreement with the mortgagors which permits them to temporarily make partial payments and work toward a permanent solution to the projects' financial problems.

Officials in the Office of Multifamily Finance and Preservation told us they attempt to have all delinquent mortgages under terms of a workout arrangement within 6 months of assignment.

Our analysis showed that numerous delinquent mortgages are not under workout arrangements. For example, of the delinquent mortgages not in foreclosure, only 382 had current workout arrangements, and about one-fourth of these were delinquent in terms of their workout. Of the mortgages which did not have current workout arrangements and were not in foreclosure, we identified 283 mortgages that were over 1 year delinquent. We could not find evidence of any workout arrangements for about one-third of these mortgages. Many others had workout arrangements which had expired several years ago.

If an acceptable or financially feasible workout cannot be arranged between HUD and the owner, the mortgage will probably never become financially stable. Thus, HUD loan servicers need to expeditiously recognize the point at which a mortgage cannot be reinstated and initiate foreclosure proceedings promptly.

Currently, HUD is negotiating with a contractor on a plan to design improved methods and systems for use in developing workout arrangements. The proposal calls for establishing a uniform, systematic approach to developing effective workout arrangements. An interim report is expected later this year.

## FORECLOSURES OF MULTIFAMILY MORTGAGES

Foreclosures of HUD multifamily mortgages take an average of over 2-1/2 years to accomplish and have been applied inconsistently, based on the financial status of the mortgages. Extended proceedings in initiating foreclosure and obtaining control of projects results in increased losses to the Federal Government and may result in hardships on tenants because projects often deteriorate after mortgagors become aware of a potential foreclosure action.

During fiscal year 1979 HUD acquired 99 multifamily mortgages. Based on readily available data, we were able to analyze 54 of these mortgages and found the average time from the date the Office of Multifamily Financing and Preservation requested foreclosure until the foreclosure was actually accomplished was 31 months. The range was from 4 to 59 months.

We also reviewed information on 178 foreclosure actions that are currently in the process of judicial foreclosure. Records maintained by HUD's Office of General Counsel indicated that, on the average, it took about 7 months from the time the financing and preservation office requested foreclosure until HUD's Office of General Counsel forwarded the case to the Department of Justice. The records also indicate that these 178 foreclosure actions have been with the Department of Justice and U.S. Attorneys for an average of 26 months without final resolution.

Of the mortgages currently in foreclosure, 100 were delinquent for less than 2 years and totaled about $22 million. Yet 139 mortgages, totaling $82 million, were more than 2 years delinquent and were not in foreclosure or under current workout. Thus, the amount of delinquency for the mortgages not in foreclosure or under workout is about four times greater than those already in foreclosure. This raises a question of consistency of HUD's foreclosure actions based on the financial status of the mortgages. HUD officials acknowledged that a firm foreclosure policy does not exist but stated that such a policy is being developed. As mentioned earlier, other factors in addition to financial considerations influence HUD's decision on foreclosure.

After mortgagors become aware of a potential foreclosure action but before actual control is removed from the mortgagor, projects are susceptible to deterioration and diversion of funds. This results in increased losses to HUD's mortgage insurance funds (HUD has estimated that upon acquisition, the average project needs about $600,000 in repairs) and hardships for the tenants who live in these projects. In a recent Area Office Managers' workshop participants expressed concern about the time involved in foreclosures. A HUD memo on the workshop indicated that:

> "The most critical problem period is from the time the mortgagor becomes aware of the potential foreclosure action and the transfer of possession and control to

> HUD as mortgagee-in-possession or to a judicially appointed receiver. It is that time period that presents the greatest opportunity for diversions by owners or managers, lack of maintenance and firm management of the project with consequent physical deterioration, all with adverse impact on the tenants."

In spite of the above, HUD's General Counsel's records indicate that many projects in the foreclosure process are still controlled by the mortgagors. HUD officials told us that when foreclosure is initiated, control of the projects is requested, but is not always granted by the courts.

HUD's Office of Inspector General recently issued a report on a nationwide audit of HUD's timeliness in foreclosing multifamily project mortgages. The report identified significant delays in recommending, approving, referring, and completing foreclosures. The Inspector General noted that delays occurred because field offices were not prompt in initiating action to bring mortgages current and did not obtain workout arrangements in a timely manner. Additionally, the report stated that unrealistic workout proposals were accepted, inadequate determinations were made as to the prospects for reinstatement, and foreclosure was not recommended when the terms of the workout were not met. Other delays occurred, according to this report, in the referral and completion of foreclosures by HUD's General Counsel and the Department of Justice.

## TAX BENEFITS OF PROJECT OWNERSHIP NEED TO BE MONITORED

During the period owners are delinquent in their mortgage payments and while foreclosure on mortgages is in process, Internal Revenue Service (IRS) officials said the project owners can claim income tax deductions for accrual of unpaid interest and depreciation expenses. Justice, HUD, and IRS officials acknowledged that owners often contest foreclosure actions to extend the period of time in which they can benefit from accrued interest and depreciation deductions on their Federal income tax returns.

However, at a January 10, 1980, meeting, IRS officials told us that under the tax benefit rule (26 CFR 1.111-1(a)), unpaid expenses--including accrued interest expense--which had previously been claimed as deductions should be recaptured in the year the liability for such expenses ends. IRS could not estimate the amount of money which has been recaptured from owners for accrued interest or depreciation deductions on mortgages which have been foreclosed. This information is not available, according to IRS, because examinations or audit results are not maintained by type of issue or adjustment.

IRS officials have stated in congressional testimony that IRS is concerned that taxpayers fail to report depreciation recapture and other deferred adverse tax consequences. In a May 18, 1979, letter to GAO on a related issue, IRS stated that it had recently developed a draft prospectus for a study regarding recapture provisions on low-income housing projects. The study is to measure taxpayer compliance levels in recapturing additional depreciation expenses and to determine the feasibility, costs, and benefits of using HUD information on real property defaults, foreclosures, and ownership changes to monitor compliance with the tax code.

In our January 10, 1980, meeting with IRS officials, we were told that the above-mentioned study plan has not been approved by IRS and therefore we could not obtain a copy. These officials did state that the study would be completed by the end of 1981 if HUD provides IRS certain needed data on schedule. They did acknowledge, however, that the subject of accrued interest expense was not included as part of the study plan, but, based on our concerns, agreed to add it to the study.

As of September 30, 1979, the total accrued interest delinquency on HUD-held multifamily mortgages was about $325 million. Since about three-fourths of these projects are owned by profit-motivated mortgagors, substantial income tax revenues could be lost to the Federal Government, if not recaptured, because deductions are allowed for expenses which are not actually paid. That part of the accrued interest delinquencies which may eventually be paid by project owners, as well as those subsequently recaptured, will not result in lost tax revenues. However, for many mortgages which are seriously delinquent and those in foreclosure, the likelihood of accrued interest ever being paid to HUD is small.

Thus, the already lengthy process of foreclosure which results in project deterioration, mortgage insurance losses to HUD, and hardship for tenants, is exacerbated by monetary incentives to delay foreclosures based on income tax considerations.

Because IRS does not know the amount of recapture of accrued interest and depreciation deductions from foreclosed multifamily mortgages and because IRS, HUD, and Justice officials acknowledge that the income tax advantages are an important consideration for project ownership, the tax consequences should be closely monitored.

## CONCLUSIONS AND RECOMMENDATIONS

HUD has a difficult task in managing its multifamily-assigned inventory, which admittedly are troubled mortgages; however, improvements can be made to minimize mortgage insurance losses and to protect the safety and welfare of the tenants living in these projects. When mortgages are assigned to HUD, it must expeditiously decide whether mortgage payments on the project can be brought current. If reinstatement is possible, a workout arrangement should be initiated promptly; if reinstatement is not possible, HUD should initiate foreclosure.

However, many seriously delinquent mortgages are neither in foreclosure nor under current workout arrangements. Carrying out these decisions promptly could prevent project deterioration and the possibility of diversion of project funds, save millions of Federal dollars, and protect tenants from hardships.

HUD officials told us that the Department had recently increased field office staffing levels by 357 positions, from 793 in 1977 to 1,150 for 1979, and is now planning to (1) require annual operating budgets for projects, (2) perform annual management reviews, and (3) train field personnel in both the loan management and property disposition functions. HUD officials told us they are also exploring ways to reduce the tax benefits of delinquent, uncooperative project owners.

We believe HUD can do more to improve the management of its assigned multifamily inventory. Specifically, we recommend that the Secretary, HUD:

--Achieve consistency in data used by various HUD offices by developing a single, comprehensive management information system capable of disclosing accurate and timely data on the status of assigned mortgages.

--Make expeditious determinations, after assignment, as to whether a mortgage can realistically be brought current, and thereafter either place the mortgage under a closely monitored workout arrangement or proceed promptly with foreclosure.

--Work with the Department of Justice and the Internal Revenue Service to identify causes of delays and alternatives, including legislative remedies if appropriate, for reducing the time periods and Federal losses (including those through the income tax process) resulting from lengthy foreclosure proceedings.

--Pursue more effective and timely efforts in obtaining control of project operations once a decision to foreclose is made.

HUD officials generally agreed with our conclusions and recommendations and stated that they had already begun to take, or plan to take, action to correct identified deficiencies or problems noted in our report.

HUD officials acknowledged that the foreclosure process is cumbersome and lengthy. These officials stated that HUD has begun exploring means of reducing the length of time necessary to process foreclosures, but indicated that, in their opinion, the situation is not likely to improve significantly unless several legislative remedies are developed and enacted by the Congress. These remedies include elimination of certain favorable tax advantages for mortgagors; the exemption of HUD from Federal bankruptcy laws; and enactment of a uniform Federal foreclosure law applicable to HUD projects.

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As your office requested, we did not obtain written agency comments on our review. We met, however, with HUD, Justice, and Internal Revenue Service officials and have incorporated their comments where appropriate.

As discussed in our November 13, 1979, testimony before your subcommittee, we currently have several ongoing reviews related to HUD's multifamily programs. We will provide the subcommittee with copies of the resulting reports when they are issued or released by the requesting parties.

Your office requested that we make no further distribution of the report prior to committee hearings, now scheduled to be held on January 23, 1980.

Sincerely yours,

Elmer B. Staats

Comptroller General
of the United States

Enclosure

## ASSIGNED MORTGAGES MORE THAN FOUR YEARS DELINQUENT NOT UNDER WORKOUT NOR IN FORECLOSURE AS OF SEPTEMBER 30, 1979

| Project name and location | Amount of delinquency | Months delinquent | Percent of interest delinquency to outstanding principal balance | Expiration date of latest workout |
|---|---|---|---|---|
| Acorn Redevelopment Project, Oakland, Cal. | $ 1,935,233 | 51 | 12 | 12-31-77 |
| Brightmoor Terrace (Parcel 34), Boston, Mass. | 1,260,879 | 49 | 19 | 4-30-76 |
| Camfield Gardens, Boston, Mass. | 879,381 | 51 | 13 | 4-30-78 |
| Chicago's Best Landlord, Chicago, Ill. | 44,686 | 54 | 19 | (a) |
| Edgewater Village, Edgewood, Md. | 445,177 | 136 | 14 | (a) |
| Geneva Apartments, San Francisco, Cal. | 3,345,071 | 70 | 15 | 11-30-78 |
| Methunion Homes, Boston, Mass. | 1,486,463 | 63 | 19 | (a) |
| Mulberry Square Apts., Syracuse, N.Y. | 1,491,207 | 54 | 16 | 7-31-79 |
| Predow Apartments, Wilmington, Del. | 276,555 | 53 | 19 | 7-31-78 |
| Roxse Homes, Inc., Boston, Mass. | 2,498,083 | 51 | 13 | 8-31-79 |
| United Housing Development #2, Middletown, Ohio | 250,002 | 49 | 14 | (a) |
| Woodlawn Gardens, Chicago, Ill. | 3,321,100 | 61 | 18 | 12-31-76 |
| Total | $17,233,837 | | | |

a/We could not find any evidence of HUD ever executing a workout arrangement for this mortgage.

## HUD'S MULTIFAMILY ACCOUNTING SYSTEM

Mr. SCANTLEBURY. As you mentioned, we are primarily going to talk about the accounting problem HUD has and the effect these accounting problems have upon the multifamily mortgage system. We first reported on the accounting weaknesses in this area in 1975 when we examined HUD's system for the payment of taxes on HUD-owned property. At that time, HUD informed us of its plans to institute a highly automated system called HUDMAP which was to be the solution to most of its accounting system problems. The HUDMAP system has not been completed and is currently planned to be completed by October 1981. The new system should address itself to many of the current problems. We believe, however, since that planned implementation of the system is almost 2 years away, interim changes must be made to the current system to correct some of the problems and we found it helpful in discussing some of these accounting problems and the way the system works to discuss how the flow of transactions occur. We have prepared a chart and I have asked John Cronin if he would explain to you how the system works.

John.

## MONITORING AND SERVICING MORTGAGES

Mr. CRONIN. I would like to briefly explain how HUD's accounting system for Secretary-held multifamily mortgages works. By giving you an overview of the system described on the chart we have here this morning, a copy of which is attached to Mr. Scantlebury's statement, we believe you will better understand how the system works and where some of the breakdowns are occurring.

The accounting system for HUD's Secretary-held multifamily mortgages is maintained at headquarters in Washington. The day-to-day activities of monitoring and servicing the mortgages are the responsibility of HUD's local field offices. When an insured mortgagor defaults, the mortgagee can foreclose and turn the property over to HUD or assign the mortgage to HUD.

When assignment is chosen, as it is in most cases, an insurance claim is filed by the mortgagee, the mortgagee is paid off, and HUD becomes holder of the mortgage. When the property becomes assigned, the project becomes part of the Secretary-held inventory. HUD also establishes a billing record in the Department's Office of Finance and Accounting in Washington. During this period, the field office is responsible for deciding if reinstatement is possible or if foreclosure should be initiated.

## REINSTATEMENT

If reinstatement is considered possible, the field office should enter into an agreement with the mortgagor for a payment plan to provide an opportunity for the project to make partial payments while working toward a permanent solution to the project's financial problems. This plan, called a workout agreement, is often set with amounts substantially less than the normal mortgage payment due before assignment. According to HUD regulations, workout agreements are generally entered into for a period of 6 months, after which time the agreement is extended or modified; the mortgage is recast with a plan to provide for full repayment; or it is foreclosed. After OFA establishes a billing file, it sends monthly bills to the projects' managing agents; these monthly bills include data on amounts received in the previous month. A copy of the monthly bill is also sent to the servicing field office.

This is where HUD's problems begin. Without accurate inventory records, bills will either not be sent out at all or will not be received promptly by both the mortgagor and the servicing office, making servicing difficult. For example, we reconciled the inventory files of the New York field office and OFA as of May 1, 1979, and we found a number of discrepancies, six projects in one case that belonged in another field office and in another case we found one project with a mortgage balance of $300,000 that was lost in the inventory. The New York office was not aware of it. Fortunately, the mortgage was current.

Also, if the bill to the managing agent is not timely, this can help foster late payment or nonpayment. If the bills, which also show payment data, are late or not received by the field office, they will not receive or will receive late, information on payments made the previous month. Unfortunately, HUD's central accounting system only provides billing on the basis of the terms of the initial mortgage and not under the terms of the workout agreement. The information produced by the central accounting system is of little value to field personnel who need to know the current status of each mortgagor in terms of the reduced payments required under the workout agreement. Managing agents make their payments directly to Washington.

### TAX ESCROW ACCOUNT

Washington also manages a tax escrow account for each project and receives and pays local tax bills. This, too, causes HUD problems because of the difficulties a centralized unit experiences in long-distance dealings with the many taxing authorities. We have previously reported on problems with centralized tax systems at HUD and suggested decentralization, which HUD implemented for its acquired single-family properties.

### MONTHLY AND ANNUAL FINANCIAL STATEMENTS

In addition to monthly billing information, two other important management tools are available at each area office. These are annual financial reports from independent public accountants as well as monthly accountings submitted by each mortgagor. The monthly and annual statements provide HUD with an opportunity to determine the financial status of the projects and to identify questionable financial transactions which the agency can bring to the attention of the managing agents. We feel these tools are very important. Mr. Scantlebury will cover this point as he continues.

Mr. SCANTLEBURY. We acknowledge that HUD really has a formidable task in servicing all the assigned multifamily mortgages that it has to handle. However, as of September 30 of this last year, HUD held 2,032 project mortgages valued at approximately $3.7 billion and about 71 percent or 1,442 of these projects were delinquent in mortgage payments. The accrued interest on these was about $325 million. For these delinquent mortgages, there were 696 of them for which there was no current workout arrangement, 382 were under current workout arrangement, and 364 were in the foreclosure process.

## INCOME TAX DEDUCTIONS

I would also like to mention a problem during the period the owners are delinquent in their mortgage payments and while foreclosure on mortgages are in process. Internal Revenue Service has said owners can claim income tax deductions for accrual of unpaid interest and depreciation expenses. As of September 30, 1979, the total accrued interest delinquency on HUD-held family mortgages was about $325 million. Since about three-fourths of these projects are owned by profit-motivated mortgagors, substantial income tax revenues could be lost to the Government because deductions are allowed for expenses which are not actually paid.

## HUD SERVICERS RECEIVE INADEQUATE INFORMATION

Mr. Cronin touched on how the accounting system does not track the payment status under the terms of workout agreements. I will not go into that anymore except to say that in San Francisco we found HUD, contrary to their procedures for centralized payment, was receiving payments locally for most of its inventory of Secretary-held mortgages.

One of the problems we found was that monthly bills were received in HUD field offices late. One example is the June 1979 monthly bills for the New York field office which showed the amounts due as of June 1, 1979, and the payments received in May 1979 were received by the servicers in the New York field office on July 2, 1979, over a month late.

The people who handle these mortgages really need that information on a current basis to do their job properly.

I will briefly mention that the system does not provide adequate penalties for late payment and HUD does not provide adequate incentives to mortgagors to make their payments by the due date. At the time of our review, late penalties were assessed on mortgagors who were current under their mortgage terms and who made a late payment. Since the majority of the Secretary-held mortgages are delinquent under the mortgage terms, few late penalties are actually assessed.

## TAX STATUS OF NEW YORK PROJECTS

Then I would like to talk a little bit about the tax status of the New York Secretary-held project mortgages. We reviewed 26 selected projects at the taxing authorities in the cities of New York and Yonkers. We found numerous under- and over-payments reflected on the records of the tax authorities. For example, 8 of the 26 projects owed delinquent real estate totaling nearly $40,000. We found one project listed as exempt from taxes. It was exempt only for real estate taxes and not water and sewage charges. Because the water and sewage had not been paid for 4 years, the city of New York started action to take over the property for nonpayment.

### LOAN SERVICING AT HUD'S NEW YORK FIELD OFFICE

We also found that major improvements are needed in the servicing at HUD's New York field office. On May 1, 1979, the 26 projects I mentioned before were in the following status: Five projects had never been under workout agreement since assignment, even though they were assigned as far back as 1975. Nine projects had expired workout agreements but were still delinquent. Two projects were serviced under an informal agreement and 10 projects were either under permanent modification agreement, current workout agreement, or had been recommended for foreclosure.

We found problems with the financial analysis. HUD requires annual financial reports for each project. They are to be certified as to accuracy and conformity to generally accepted accounting principles by both an independent public accountant and officer of the mortgagor.

Senator PROXMIRE. Let me get into my questions. If you feel we fail to adequately cover your prepared testimony in the questioning period, call that to our attention.

### PRIOR GAO REPORTS

The problems in HUD's multifamily inventory seem overwhelming. You stated that GAO previously reported on HUD's overall management of the inventory of multifamily projects. Did you find the same problems during your 1975 review?

Mr. SCANTLEBURY. Yes. In March of 1974, we issued two reports based on our review of the program. At that time, HUD held mortgages on 1,098 multifamily projects with outstanding principal balances of about $1.2 billion. Since that time, the number of mortgages held by HUD has approximately doubled while the dollar value has increased to $3.7 billion.

Senator PROXMIRE. So the situation is worse than it was in 1975, at least in terms of volume?

Mr. SCANTLEBURY. Yes; the dollar amounts involved are greater and the number of mortgages involved increased.

Senator PROXMIRE. Is there any other basis for comparison between the situation now and then?

Mr. CRONIN. Many of the situations are the same, Senator. In our earlier reports, many of the recommendations we made are the same recommendations that were made in 1974.

Senator PROXMIRE. How has HUD responded?

Mr. CRONIN. The situation has not been corrected, Senator.

Senator PROXMIRE. Your response certainly doesn't indicate, as the Secretary of HUD indicated to us late last year, that the Department has made improvements or that, as was indicated earlier, we have a different ballgame now than we had when the previous Republican administration was in office.

Mr. CRONIN. I think in 1974 we particularly cited the servicing problems in the field office.

Senator PROXMIRE. Do those problems still exist?

Mr. CRONIN. Yes; it seems there is a communications gap between the central office and field offices. The central office, which was mentioned in earlier testimony, is trying to take action on these problems. Somehow, most of the field offices don't do what they are supposed to do.

### NEW YORK PROJECTS

Senator PROXMIRE. In your testimony, you indicated you selected certain New York projects for review after finding a number of potential diversions. Could you identify the projects?

Mr. SCANTLEBURY. Yes. We have identified Carol Management Co. projects called Independent Park section 1, Independent Park section 2, Independent Park section 3, River Terrace Apartments, and Central Gardens unit 1. At the Axelrod Management Co., there were seven projects called Delano Village projects 1 through 7.

Senator PROXMIRE. You indicated you visited two management agents in New York. What was the relationship between the owners and the management agents?

Mr. SCANTLEBURY. The principal of the Carol Management Co., that is one of the two, and the five projects was the same. The principals of the Axelrod Management Co. and the seven Delano Village projects also were the same.

Senator PROXMIRE. You stated one managing agent was involved in a potential diversion of $2.7 million in project funds. What was the name of the project?

Mr. SCANTLEBURY. Delano Village 1 through 7.

Senator PROXMIRE. Can you tell us how many Delano Village mortgages you reviewed and also go into a little more detail on what you found?

Mr. SCANTLEBURY. We reviewed all seven of these mortgages. Five were assigned to HUD while two were current, with FNMA holding the mortgages. When we started the audit in May of 1979, we were advised that $2.7 million at the Delano Village projects had been withdrawn for other than operating purposes. We subsequently monitored the action taken by the field office. In October, 1979, we finished our planned field work at the New York area office. At that time, the Delano projects were not in foreclosure and had not repaid the funds.

In a meeting with the Deputy Director of Housing Management on October 31, 1979, we advised HUD that GAO was going to put all our unanswered questions in writing to HUD on these projects. Shortly after that meeting, we were supplied with a November 7, 1979, memo from the New York office recommending to headquarters that the mortgages be foreclosed. By that time we decided to visit the projects and perform audit work there.

Senator PROXMIRE. How long have the diversions been going on?

Mr. SCANTLEBURY. It has been about 5 years.

### ACCOUNTING RECORDS OF MANAGING AGENTS

Senator PROXMIRE. What was the state of the records at the Delano Village projects? Were they maintained in accordance with HUD regulations?

Mr. SCANTLEBURY. No; we found several things that were at variance with the HUD requirements.

Senator PROXMIRE. How serious were those variances? Were they technical or significant?

Mr. SCANTLEBURY. For one thing, they didn't maintain a separate cash account.

Mr. CRONIN. The cash, Senator, in both management companies we went to was commingled with the other business activities. So, therefore, it becomes impossible to trace what happens to the cash when many other profitmaking activities of these managing agents are merged.

HUD regulations require a separate cash account. This way the cash can be identified. Also, other books and records were commingled making it very difficult for us or anybody else to audit.

Senator PROXMIRE. Did you point out to the managing agents that the books were not being kept in accordance with HUD regulations?

Mr. SCANTLEBURY. Yes, we did.

Senator PROXMIRE. What was their reaction?

Mr. SCANTLEBURY. They said maintaining the books in accordance with HUD regulations would be too costly. They were getting 6 percent of the income as management fees. That is what they say.

Senator PROXMIRE. How much was that 6 percent in dollars?

Mr. CRONIN. One managing agent in 1 year received about $280,000 in management fees. The other received about $380,000.

Senator PROXMIRE. In your judgment, how costly would it have been to maintain the books in accordance with HUD regulations?

Mr. CRONIN. I can't give you a precise figure.

Senator PROXMIRE. But it would have cost far less than the management fees?

Mr. CRONIN. Yes, particularly to have separate cash accounts. I do not think that would be very difficult at all. The Delano Village projects did have a separate bank account, but as soon as the cash receipts went in, they didn't stay there very long. They were transferred to another bank account that was used for the managing agent's other business activities.

Senator PROXMIRE. Has there been any action to correct this situation?

Mr. CRONIN. No, Senator.

Senator PROXMIRE. Did your analysis of the financial statements of these projects indicate that any of the projects in default generated enough income to pay HUD?

Mr. SCANTLEBURY. Yes. In 1978 one of the seven projects operated at a profit. This mortgage was current and was held by FNMA. Total operating losses of all seven projects for 1978 was about $210,000. However, of this total loss, about $514,000 was charged off as depreciation expense. Therefore, since depreciation doesn't require payment of cash, they had cash available to pay HUD some of what was due them.

### FINANCIAL STATEMENTS

Senator PROXMIRE. I understand that five of the projects handled by Carol Management had deficient financial statements. Could you name the projects?

Mr. SCANTLEBURY. Independent Park sections 1, 2, and 3, River Terrace, and Central Gardens unit 1.

Senator PROXMIRE. Did the area office refer the financial statements to HUD audit for additional review?

Mr. SCANTLEBURY. No; the branch chief assigned them to a loan servicer who didn't have an accounting background. The servicer was assigned the responsibility of contacting the independent public accountant to deal with the technical accounting matters.

We also know that the team captain responsible for four of the five projects had requested a HUD audit but the chief, instead, referred them to the other servicer. The servicer then asked GAO to assist him in dealing with the independent public accountant.

Senator PROXMIRE. You indicated that the financial statements were deficient. Could you describe some of the deficiencies in the financial statements?

Mr. SCANTLEBURY. We had some problems with the year-end cash balance of several statements which didn't agree. Some of the statements were missing. For instance, they didn't have a statement of changes in financial position. They didn't have a statement of the owner's equity. Both of those are required by HUD and also required by generally accepted accounting principles.

One project had land dropped in and out of the financial statements. We couldn't figure out how that was happening. That normally would not be within generally accepted accounting principals.

Senator PROXMIRE. I understand some questions arose regarding the objectivity and ability of the independent public accountant who was auditing the books for Carol Management. Could you elaborate on that?

Mr. SCANTLEBURY. The independent public accountant also serves as the internal auditor and seems to be very heavily involved in the maintenance of the financial records for the management agent, Carol Management.

Senator PROXMIRE. Does that mean he was auditing his own books?

Mr. SCANTLEBURY. That is basically what it appears to be; yes.

### REVIEW BY INSPECTOR GENERAL OF HUD

Senator PROXMIRE. On page 16 of your prepared testimony, you indicate that the regional inspector general for audit reviewed assigned projects serviced by the New York area office. Were any diversions uncovered? If so, what actions did HUD take?

Mr. SCANTLEBURY. You are asking about the diversions reported by the regional inspector general?

Senator PROXMIRE. That is right, diversions from projects serviced by the New York area office.

Mr. SCANTLEBURY. He had identified potential diversions at Twenty-One Hundred Inc., of $120,000, and at the Hinsdale Street rehabilitation project of about $20,000. We had informed HUD's regional counsel of the reported potential diversions on November 30, 1979. There was no evidence prior to this meeting of HUD requesting that the potential diversions be followed up.

Senator PROXMIRE. So nothing has been done about them, so far as you know, as of this date?

Mr. CRONIN. The area office had the Justice Department follow up on one diversion. We are not aware of any action on the other diversion.

## INVENTORY PROBLEMS

Senator PROXMIRE. Mr. Cronin, in your statement you mentioned you found a project in New York that was not on the headquarters' inventory. Could you elaborate on how that happened?

Mr. CRONIN. At the time of our review, HUD had no formal requirements for inventory reconciliations between HUD field offices and the various HUD headquarters elements responsible for servicing and accounting. Without periodic reconciliations, inventory problems can go undetected for years. In fact, we have reported in the past on a number of inventory reconciliation problems, both in the single-family and the 312 rehabilitation loan programs. These inventory problems are not new. In the one instance I referred to earlier, the mortgage that was lost up in New York was fortunately current.

## LOCAL RECEIPT OF PAYMENTS

Senator PROXMIRE. On page 6 of your opening statement you state that the San Francisco area office, contrary to HUD regulations, was receiving mortgage payment checks locally and seemed to be doing a much better job than the New York area office. Does this approach create any problems?

Mr. CRONIN. It creates a cash management problem because the receipts don't come into the Government as soon as possible. That is the negative side of it. The positive side of it is that we found very aggressive servicing in San Francisco. The servicers were really trying to do their job. If there was an acceptable accounting system in Washington to provide them with the current payment information they needed they would not have had——

Senator PROXMIRE. If you go by the book you seem to do a worse job, so shouldn't we change the book?

Mr. CRONIN. Or the accounting system, one or the other.

Senator PROXMIRE. What was that?

Mr. CRONIN. Or the accounting system.

Senator PROXMIRE. What is your recommendation?

Mr. CRONIN. That the system provide the servicers timely information immediately after the payments are made. It is better if the checks are deposited immediately so the Government can get the benefit of the cash. Without a good system supporting the servicers, they have got to have something. So we have no serious objection other than the cash management problem of what they were doing out there because their statistics bear out they were doing a better job than most of the other field offices.

## WORKOUT AGREEMENT

Senator PROXMIRE. Were the projects managed by the managing agents you visited in New York City under a workout agreement?

Mr. SCANTLEBURY. No; none of the eight delinquent projects were under a workout agreement. However, only the two——

Senator PROXMIRE. Without a workout agreement, how would HUD know if the payment received is a just amount based on the ability to pay?

Mr. SCANTLEBURY. The servicer should review the monthly and annual financial statements to determine the financial conditions of the project. From reviewing the monthly accounting statements, HUD can determine the cash receipts and disbursements for the month plus the cash on hand at month's end. Without workout agreements, HUD is letting the mortgagor decide how much they will pay.

Senator PROXMIRE. So they can't determine the ability to pay out——

Mr. SCANTLEBURY. There is not a definite agreement as to how much they will pay.

Senator PROXMIRE. GAO's written report analyzing HUD's multifamily assigned mortgages indicates that HUD's goal is to have all delinquent mortgages under a workout arrangement within 6 months of assignment. Did you find that HUD is achieving this goal?

Mr. SCANTLEBURY. No; HUD is not achieving this goal. We identified 283 mortgages which are more than 1 year delinquent, but are neither in foreclosure nor under a workout arrangement.

Senator PROXMIRE. Put that in perspective. Is it a high percentage of the total?

Mr. CRONIN. We were looking at 1,400 Secretary-held mortgages.

Senator PROXMIRE. That would be about 20 percent.

Mr. CRONIN. Yes.

[CLERK'S NOTE: GAO later indicated that a total of 2,050 mortgages were Secretary-held and that about 15 percent were not under a workout arrangement or in foreclosure.]

### TAX CONSEQUENCES

Senator PROXMIRE. Your report indicates that the owners may be taking large tax deductions for mortgage interest even though they are not making mortgage payments on properties in the HUD inventory. Does the Internal Revenue Service have any information regarding the extent to which these deductions are being recaptured by the Government?

In my opening statement, I pointed out that $200 million in Federal revenue may be lost because of these deductions unless it is recaptured later. Many people are on an accrual basis and there is nothing wrong with that as long as they are consistent about it. What concerns me is that, as I understand it, the Internal Revenue Service never does collect.

In other words, what happens is that you owe the interest but you don't pay the interest; even though you don't pay it you subtract it from your income in computing your income tax. Theoretically, if you never paid the interest, you would have to pay the tax at some later time. I understand in many cases the tax is never paid.

Mr. SCANTLEBURY. The way it should work out, if foreclosure takes place and the transaction is ended, then the expenses they deducted in prior years but don't have to pay should be picked up—recaptured is the word they use.

Senator PROXMIRE. On the basis of your investigations, can you tell us whether or not this is happening?

## PLANNED IRS STUDY

Mr. SCANTLEBURY. We are aware of certain information which the IRS has developed. This data is the result of two limited field office studies in Dallas and Los Angeles. It is not statistically valid. It is just a small sample and indicates a high degree of noncompliance.

Senator PROXMIRE. As I understand it, above 85 percent of the money was never collected. That is a pretty nice gimmick to avoid your taxes. Does the IRS have a specific program for recapturing improperly claimed deductions or even identifying the eligibility of such deductions for recapture by the Government?

Mr. SCANTLEBURY. They told us they have no specific program. However, a planned study by IRS will be looking into the possibility of whether they should do it.

Senator PROXMIRE. How does the IRS become aware of what is due to the Federal Government because of deductions that have been claimed for expenses that were never incurred?

Mr. SCANTLEBURY. One of the ways, of course, is voluntary compliance by taxpayers, which the Internal Revenue System depends on a good bit. Selected examination of returns is another method and a third is informants.

Senator PROXMIRE. Do you think a recapture program should be put into effect?

Mr. SCANTLEBURY. Excuse me.

Senator PROXMIRE. Should a recapture program be put into effect? Do they need to put more effort into this area? On the basis of admittedly inadequate samples, as you point out, the Government is losing a good deal of money here.

Mr. SCANTLEBURY. We think it is an important area.

Senator PROXMIRE. If there were better communication between HUD and IRS, it seems to me the Government would pick up a lot of money.

Mr. SCANTLEBURY. Yes; there should be that kind of communication established.

Senator PROXMIRE. In your discussion with IRS, HUD, and Justice Department officials, did they indicate that they believed the owners are aware that accrued interest claimed, but not paid, must be recaptured through the income tax process?

Mr. SCANTLEBURY. Officials in each agency indicated foreclosure is often contested on the basis of income tax considerations, and since most of the owners are in the 50- to 70-percent income tax bracket, either they or their tax counselors should be aware of the disadvantages as well as the advantages.

Senator PROXMIRE. What is the target date of the recapture study? Does it appear that the deadline will be met?

Mr. SCANTLEBURY. In our January 10, 1980, meeting with the IRS officials, we were told the above-mentioned study plan has not been approved by IRS and therefore we could not obtain a copy. These officials did state the study would be completed by the end of 1981 if HUD provides IRS certain needed data on schedule.

They did acknowledge, however, that the subject of accrued interest expense was not included as a part of the study plan, but based on our concerns, they agreed to add it to the study.

Senator PROXMIRE. I want to thank you gentlemen very, very much, once again. As I have said many times, the GAO is absolutely indispensable and enormously helpful to us. This is a fine example of the good work you have done.

### QUESTION SUBMITTED BY SENATOR MATHIAS

I also have a question from Senator Mathias that he would like you to respond to for the record.

[The question and answer follow:]

### ACTIONS TAKEN TO RESOLVE PROBLEMS

*Question.* In the course of your testimony, you have identified a series of problems in the management of HUD's multifamily housing program. Could you please, for the record, briefly restate those that you consider to be the most serious?

Could you please indicate whether HUD currently has a program underway to address each of these problems and could you please provide us with your assessment of the adequacy of the proposed HUD action. What specific further actions must be undertaken by HUD to assure that the management problems in HUD's multifamily programs are resolved?

Answer. HUD has serious problems in its accounting and servicing functions for Secretary-held project mortgages. These problems have been brought to HUD's attention in both current and past reports and testimonies.

The most serious problems with HUD's accounting system is its failure to supply servicers with the information necessary to aggressively monitor troubled projects. This problem results from the system's failure to report the payment status of the mortgages under the terms of workout agreements, to get monthly bills to the servicers prior to the due date of the payments, and to promptly bill newly assigned mortgagors. In addition, the system did not assess late charges on delinquent mortgagors to encourage mortgage payments by the due date and had no effective mechanism to reconcile the tax status of the properties at the local taxing authorities to HUD's records.

HUD officials were in agreement with our suggested accounting improvements and agreed to make changes to correct the current problems prior to HUDMAP's implementation. As explained to us, these corrective actions include establishing an interim billing system for newly assigned mortgages, reporting mortgagors' payment status under the terms of workout agreements, issuing all bills by the 20th of the month prior to the due date, performing periodic inventory reconciliations between HUD field offices and responsible headquarter's branches, and decentralizing to the HUD field offices the responsibility to obtain tax bills and periodically reconcile HUD's tax records to those of the taxing authorities.

These corrective actions, when implemented, should correct the accounting problems identified in our review.

In addition to accounting weaknesses, HUD has many serious problems in its loan servicing function. The more serious problems include HUD's failure to place all defaulted mortgagors under workout agreements, the failure to adequately review monthly and annual financial statements, the time necessary to bring about foreclosure, and the tax benefits that accrue on expenses which are owed but not paid.

HUD is aware of these problems and has stated that corrective actions are taking place. For problems such as placing defaulted mortgagors under workout agreements and reviewing monthly and annual financial statements, HUD can internally correct the problems by placing emphasis on corrective actions. HUD's new systems, the Office of Loan Management System (OLMS) and the multifamily insured and direct loan information system (MIDLIS), should be valuable tools to help loan servicers perform their duties. However, these systems only supply information and are not a substitute for aggressive servicing by loan management personnel. In the areas of foreclosure and tax benefits HUD will need to work closely with both the Department of Justice and the Internal Revenue Service to bring about improved reporting and tracking systems.

HUD must also work closely with Congress to consider the elimination of certain favorable tax advantages for mortgagors, the exemption of HUD from Federal bankrupting laws, and the enactment of a uniform Federal foreclosure law applicable to HUD projects. HUD is aware of each of these problems and has stated that changes or legislative proposals are taking place or are under consideration.

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# DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

## STATEMENT OF LAWRENCE B. SIMONS, ASSISTANT SECRETARY FOR HOUSING AND FEDERAL HOUSING COMMISSIONER

## ACCOMPANIED BY WILLIAM A. MEDINA, ASSISTANT SECRETARY FOR ADMINISTRATION

Senator Proxmire. Our next two witnesses are Lawrence B. Simons, Assistant Secretary for Housing and the Federal Housing Commissioner and William A. Medina, Assistant Secretary for Administration both representing the Department of Housing and Urban Development.

Gentlemen, it is always a pleasure to have you appear before the subcommittee. I understand you both have rather lengthy prepared statements. Secretary Simons has a luncheon scheduled at the Vice President's mansion. He serves excellent food. I don't want to deprive you of that. I suggest we follow a little different procedure in this case. You are a veteran witness as well as a tremendously competent person, Mr. Simons, and so are you, Mr. Medina. What I suggest we do is go right into questions now. If we have a few minutes left and you would like to bring to our attention something we haven't covered in the questioning period, we can cover that ground.

Is that all right with you?

### STATEMENT OF LAWRENCE B. SIMONS

Mr. Simons. The last time I disagreed with your format, but I appreciate your spirit of cooperation.

Senator Proxmire. The last time you didn't have that tempting lunch at the Vice President's mansion.

### TIMETABLE FOR MANAGEMENT REFORMS

Before we get into specifics, I want to thank you and Secretary Medina for your very helpful statements which will be printed in full in the record. I also want to ask you to provide for the record a timetable for the implementation of each of the reforms you mention in your statements. I would like to receive on the first day of every other month a written report on the progress you are making in meeting that timetable together with a specific explanation of any delays you may be encountering in putting the needed reforms in place. I hope that when you appear before us in early May to discuss your 1981 budget you will have made significant progress in dealing with the problem.

Is that satisfactory?

Mr. Simons. We will be very happy to do that. We will do that internally and be very happy to keep the committee informed.

[The statements and timetable follow:]

## STATEMENT OF LAWRENCE B. SIMONS, ASSISTANT SECRETARY FOR HOUSING AND FEDERAL HOUSING COMMISSIONER, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Good morning. I am Lawrence B. Simons, Assistant Secretary for Housing and Federal Housing Commissioner of the Department of Housing and Urban Development. With me today is William Medina, Assistant Secretary for Administration.

We are here today to discuss the management of the Department's inventory of multifamily housing projects, and to respond to issues raised both by this Committee's Investigations Staff in a report issued on November 20, 1979 and by a General Accounting Office report released this past Monday.

I think it would be useful, Mr. Chairman, to begin by reiterating the Department's position with regard to the multifamily inventory and its problems. When I came to HUD three years ago, one of my primary objectives--an objective that was shared by former Secretary Harris and has been embraced by Secretary Landrieu--was to restore and preserve the thousands of multifamily projects which the Department insures, subsidizes, or owns.

We began by analyzing the problems to determine why they had developed and what systemic flaws they revealed. Then we developed answers--answers involving new legislative authorities, new uses of existing programs, new funding sources, reorganization of field and Headquarters staff, recruitment of new, highly qualified program administrators, creation of new data systems, development of new regulations, handbooks and procedures, increased field and classroom training for staff, and substantial increases in personnel assigned to the multifamily management function.

On December 5, 1979, Secretary Landrieu and I submitted for the record a lengthy paper detailing the many administrative actions underway and contemplated to improve our management of the whole multifamily inventory. I will not review that record in detail today. It speaks for itself and amply demonstrates that in terms of analyzing the problems and developing the solutions, the Department is working diligently and is beginning to make substantial progress in this area.

This work is still going on. It is work that has been very challenging and very difficult. It is work that we are very proud of. At the same time, we recognize that much work remains to be done.

Every concern that you and your colleagues have expressed with the state of the multifamily inventory is a concern that we have shared since those early days, concerns that have motivated our work. Every type of problem which has been found by this Committee's staff, by the GAO, the HUD Inspector General and the press has been a problem that we have found ourselves and that we have been working to remedy.

Why has it taken so long? Why are we still finding serious examples of these problems?

The first part of the answer is to place the issue in context. Many of the problems that have been found in the various investigations and will be discussed in these hearings already have been identified, and solutions proposed, and in many cases implemented. Many of the actions recommended by the various investigators had already been taken or were already planned when the investigations were conducted and the reports issued. Essentially, we are in the middle of changing our management approach.

More significant, however, is the magnitude of the task of managing the HUD multifamily inventory.

The Department insures the mortgages on over 14,000 multifamily housing projects throughout the United States. For the most part, these are smoothly operated, successfully run apartments providing decent housing for some 1.7 million rental households at all income levels.

In addition to the insured inventory, the Department itself acts as the mortgagee on an additional 2,034 multifamily projects, representing a mortgage balance of some 3.9 billion dollars and containing roughly 260,000 units of housing. These are projects which failed financially at some point and either had their mortgages assigned to HUD or were owned by HUD and then sold with a purchase money mortgage. The Department owns outright another 384 projects representing 40,174 units, which it operates until they can be returned to private ownership.

Together, these nearly 17,000 projects with 2.0 million units constitute the largest residential real estate operation in the world. If we were to take $200 as an average monthly rent for a unit in this universe, we would see the Department responsible for an inventory of projects which generates some 400 million dollars of rental income every single month.

To oversee this inventory, the Department has an authorized strength of about 1,000 field staff nationwide and an additional 77 staff in Headquarters. If we count just front line loan servicers, the people with the direct day-to-day responsibility, those people, on the average, are each responsible for dealing with the problems of over 45 projects apiece.

You do not turn around an operation of this magnitude overnight. You do not turn around this operation simply by making everyone an investigator and checking out every expenditure by every project; no Federal agency has the manpower needed to do comprehensive investigations of all its cases. You do not turn around this operation by zeroing in on individual projects. Instead, we have worked to turn around our operations by putting improved systems into place--data systems which are comprehensive management tools, management systems and goals, improved training and performance evaluation systems.

I would stress that these systems will not catch every error; they will not identify every questionable expenditure, avoidable delay, or dubious management practice. But the systems we are putting into place will give us the best possible control, within the limits of our resources, over the management and preservation of the multifamily inventory.

A third point about the pace at which progress has been made relates to a portion of inventory that has been of special concern in the last few years--that is, the HUD-held and HUD-owned projects. These projects represent by and large our most troublesome projects. The good ones, the well-managed, well-financed projects with high tenant morale, do not come into the HUD inventory. We get the deteriorated, the demoralized, the partially abandoned projects. Turning these projects around takes time, experience, and intensive effort. And that process is well underway.

The responsiveness of the Department's corrective efforts is evident from several investigative reports.

The GAO recently completed a major study for the House Subcommittee on Manpower and Housing of the Committee on Government Operations, on the management of acquired, formerly subsidized housing. Not surprisingly, the report recommended that HUD improve its management of these projects. Among the recommendations made, GAO suggested that the Department:

- develop a better financial information system for these projects;
- develop cost standards to evaluate project expenses; and
- improve the monitoring of project operations.

After a meeting at which my staff and I explained what actions we were already taking, GAO concluded that "the actions planned by HUD should improve HUD's management of and control over acquired projects." These are actions, I might add, which are on record with this Committee as a result of our December 5th hearing.

The Department's own Office of the Inspector General recently conducted an internal audit on the timeliness of foreclosure actions in our multifamily programs, an area in which we admittedly have problems.

While pointing out our shortcomings, the report noted that we already had taken action or were taking action across a broad front to improve our performance on foreclosures. As a consequence, the final audit report did not recommend any additional corrective measures. It is rare when program offices respond to a draft IG audit so comprehensively that further recommendations are not required, as the Offices of Housing and the General Counsel have in this case.

I would make one last preliminary point. The mechanisms we have put and are putting into place, such as the flexible subsidy and the loan management Section 8 tenant subsidy, and sophisticated management systems, will not only enable us to correct problems we have found in our assigned and acquired projects. These mechanisms will give us early warnings and early resources to avoid further problems, to avoid defaults and foreclosures, and to keep our projects fiscally sound and well run. We are not only curing problems; we are preventing them.

I would like to turn now to the Senate Committee Staff report on the management and disposition of the Department's multifamily housing inventory. This report has an underlying assumption which I find troubling. The report suggests that the issue in servicing troubled projects is purely fiscal; the problem basically financial; and the analysis of success or failure simply one of dollars and cents. We don't believe that to be true, and the context in which you have placed these hearings--the questions of tenant needs and adequate housing for lower income families--indicates that you share our broader view.

While we work to bring our projects to financial stability, we do so with the goal of managing a significant portion of the multifamily housing stock of this country, and preserving it for the mostly low- and moderate-income households who now occupy it.

Most recently the Housing and Community Development Amendments of 1978 reiterated this objective, stating that "It is the policy of the United States ... to manage and dispose of multifamily housing projects owned by the Secretary ... in a manner which will protect the financial interests of the Federal government ... and further the goals of:

- -- preserving the housing units so that they can remain available to and affordable by low- and moderate-income families,
- -- preserving and revitalizing residential neighborhoods,
- -- maintaining the existing housing stock in a decent, safe and sanitary condition,
- -- minimizing the involuntary displacement of tenants; and
- -- minimizing the need to demolish projects."

In this regard, I was pleased to note the Senate Investigations Staff conclusion on page 36 of its report, which stated in reference to our HUD-owned project operations that "if the purpose of the insured mortgage program is to provide low- and moderate-income housing, these economic and social goals are being met."

I submit to you Mr. Chairman, that that is precisely the purpose of this aspect of our Federal housing programs and we are committed to accomplish this goal in a fiscally responsible manner.

The Senate report made a number of recommendations. I think it would be helpful, rather than continue a general response to the Senate staff report, to address each of these in turn and see just where the Department is in its new management effort.

The first recommendation -- authorize area offices to initiate workouts and require agreements to be made final within 90 days of assignment.

The whole area of workout agreements and the development of plans to remedy a project's distressed condition is one to which we have devoted considerable attention this past year. For example, in 1979 we established a management goal of keeping 90% of our HUD-held projects under an approved plan during the year. A project is under an approved plan when it is current in its mortgage payments under the original terms of the mortgage, has entered into a workout agreement, or has been referred for foreclosure. Although we fell short of the 90% goal, the percentage of HUD-held projects under a plan increased from 62 percent in May 1979 to nearly 80 percent at the end of the year.

In addition, we are developing more sophisticated tools to enable loan servicers to analyze a project's financial condition and to consider potential workout agreements. This is the necessary first step in implementing an aggressive servicing approach in which HUD, not the project owner, takes the lead in reaching a resolution of the problems of assigned projects.

As part of this comprehensive approach to servicing troubled projects, we now require Area Offices routinely to conduct a comprehensive on-site management review of all troubled projects, subsidized and unsubsidized, every year. We instituted this change in FY 79 and have made it a part of our operating plan and management goals. A "troubled project" is broadly defined to include any project in default plus any project the field office believes should receive closer scrutiny.

All untroubled subsidized projects get a less comprehensive annual review while unsubsidized projects are reviewed every other year. In this way, when a project is assigned, we should already have a total picture of its problems and needs. If we have a cooperative owner, we will be able quickly to enter into a workout agreement or mortgage modification, if needed. As part of this process, we are considering delegating full responsibility for initial workout agreements to the Area Office. The important element here, I must emphasize, is the development of the analytical tools and criteria now underway in Headquarters.

Recommendation Two -- place additional emphasis on training loan servicers and accelerate fiscal year 1980 training.

We recognize the need for additional training and have given it a high priority. Headquarters and field staff, as well as Departmental contractors, are actively engaged in improving and expanding our training program for loan servicers.

This Fiscal Year, we have already held another round of formal classroom training for loan specialists and loan management branch chiefs in the flexible subsidy program, training which includes our overall troubled projects strategy and analysis.

In March, we will give an advanced training course to experienced realty specialists on the management and disposition of our HUD-owned properties. In April, the basic course in this subject will be given for our less experienced realty specialists.

Then in May, we have scheduled an advanced course in contracting and reconditioning for our HUD-owned property staff who oversee the maintenance and repair of these properties.

In June, we will conduct a basic mortgage servicing course for loan servicers with less than one year's experience, following that in July with an advanced course for the more experienced servicers. In July, we will also offer training in occupancy matters, such as income verification and tenant certification to our occupancy specialists and loan servicers. Then, towards the end of the year, personnel newly assigned to the HUD-owned project operation will receive the basic course in contracting.

This is all formal classroom training, with experienced instructors and written materials and tests. In addition, we have already received two modules of a planned five-module financial analysis course being developed by contractors through the Office of Policy Development and Research. This is a course which can be taught at the field office level by more experienced staff, as well as in a formal, centralized classroom setting. As the various reports indicate, financial analysis is a critical element of improved loan servicing and we have responded to that need.

Number Three -- develop specific criteria for foreclosure.

We are actively engaged in refining our foreclosure criteria. We are working aggressively, with the assistance of nationally respected outside contractors to fill this gap. The improved criteria will be a critical element of our overall ability to analyze a project's problems, needs, and potential solutions.

The Senate report suggests that the Department is unwilling to foreclose on projects because of our policy of preserving the housing for low and moderate-income use. This is not true. There had been a moratorium on such foreclosures between February 1975 and January 1977. This moratorium was needed, first, because the Department had no mechanism in place to preserve projects for their low income tenants after foreclosure and acquisition when the original subsidy terminated, and second, because it had no way to dispose of foreclosed projects with adequate subsidies for the low-income tenants in place. Thus, foreclosure actions often led to severe displacement, project deterioration, and lengthy litigation.

Under our administration, the problem of displacement of low-income tenants after acquisition has been resolved by our policy not to charge rents in excess of what those tenants would pay if they were subsidized by the Section 8 program. The problem of preserving the low- and moderate-income character of the projects after sale has been resolved by our use of the Section 8 program for property disposition. Thus, we need not refrain from foreclosing on a formerly subsidized project because of a fear that its low- and moderate-income character would be jeopardized.

We do not, however, view foreclosure as the only remedy. We believe it preferable to work with good owners to make a project successful, avoiding prolonged litigation, the interim period of uncertainty for the project which accompanies it, and possible further physical deterioration. Flexible subsidy, mortgage relief, Section 8 and other assistance can be valuable tools in working with a cooperative, well-intentioned owner at this stage. In some cases, a change of ownership in the private sector, a transfer of physical assets between private owners with an additional cash contribution to the project by new, more experienced, more capable ownership, can provide a solution to a project's problems.

However, if we have to acquire a project to best solve its problems, we will do so as expeditiously as possible. That brings us to the next recommendation.

Recommendation Four -- establish a tracking system to follow projects in foreclosure.

This action is also well underway.

The problem of delay in the foreclosure process is a complicated one. In States with nonjudicial foreclosure statutes, like Texas, the process can be relatively rapid. In states where judicial proceedings are required, getting on the court calendar alone can be a time-consuming process. Then, if the foreclosure is contested by the owner, it can literally drag on for years. We know this is unacceptable and that the rights of owners can be respected without stretching out foreclosures interminably.

The Offices of Housing and General Counsel are jointly attacking this problem on a number of fronts. Internally, we are organizing our own procedures to streamline the process once the foreclosure decision is made and thus save as much time as possible at the outset. Weeks can be eliminated simply by reordering and consolidating the stages in the process as we are now doing. For example, in states with non-judicial foreclosures, we are implementing a procedure of direct referrals to the Area Counsel, saving time otherwise spent in processing the case at Headquarters.

To deal with delays in the judicial process, the General Counsel recently met and agreed with the head of the Civil Division at the

Department of Justice to certain steps which we believe will enable us to expedite foreclosure actions. First, we have agreed that the Department will submit to Justice a model timetable for action on foreclosures and an area-by-area analysis reflecting performance by U.S. Attorneys across the country in relation to that timetable. Where there are significant deviations from the model, action will be taken to eliminate delay, including, where appropriate, the assignment of greater litigation responsibilities to HUD lawyers or Justice lawyers in Washington.

The Department of Justice has demonstrated in recent years a capability to move promptly on critical cases. We are confident that the Civil Division will move with equal resolve to deal with foreclosures across the board. However, you should be aware that the recently enacted bankruptcy act provides recalcitrant owners with a ready means to forestall foreclosure by declaring bankruptcy. The Department sought a legislative remedy to this in 1978, and although we were unsuccessful, we plan to pursue this again in the future.

To stay on top of the judicial foreclosures, the Office of General Counsel has developed a tabular format for reporting and tracking foreclosure actions, which will be compatible with the Justice Department's new tracking system. This will enable us to pinpoint delays in the process and to take action to move cases along wherever possible. Time benchmarks will be established on the model timetable I've mentioned. Using these benchmarks, we will be able to flag cases more quickly which are not moving along in a satisfactory manner.

Nevertheless, delays beyond the control of our Departments will still be encountered, particularly in contested foreclosures. We are, therefore, considering two other options. First, we are looking at ways to take possession of troubled projects from uncooperative owners much earlier in the process. This is particularly desirable since taking possession of a project very often softens an owner's resolve to contest foreclosure. It also provides greater protection for the government. We believe we can achieve this through action on the regulatory agreement that exists between HUD and the project owner. Although such action would not conclude the foreclosure process, it would enable HUD to substitute management sooner where that is a source of problems.

Secondly, we are reexamining the desirability of seeking the authority to institute a nonjudicial foreclosure process in all 50 states for projects whose mortgages are assigned to HUD. This would give us the greatest leverage in the foreclosure situation of any I've discussed so far.

Finally, one of the subjects under discussion in the Department is the relationship of tax benefit [illegible] the owners of projects facing foreclosure. Owners who wish to avoid the recapture of excess depreciation and who wish to continue to receive income tax deductions from the accrual of unpaid interest and service charges deliberately seek to put off the day of reckoning by delaying the foreclosure. Several possible, complementary solutions to this problem have been discussed. However, they all have serious policy and program implications and will require more review as well as coordination outside of HUD.

Recommendation Five -- advertise foreclosure sales and bid the project's market value at the sale.

This is an interesting recommendation and one, quite frankly, which we had been reviewing prior to this report in relation to certain of our troubled projects, particularly vacant and incompleted structures. We believe, however, that this approach would have little application in the many cases where the government must acquire a project in order to preserve its low- and moderate-income character and to find an acceptable owner. In addition, the question of what we would do if the appraised market value were very low or zero must be considered. Many of these projects have value only as subsidized housing. However, there are circumstances in which the approach might be useful, and we will give this matter further thought.

Number Six -- provide Congress with projected costs of using Section 8 in our disposition program.

It is hard to provide any useful projection of the real costs of using Section 8 in the disposition program. On the one hand, since we get a total number of Section 8 funds, without regard to whether units go to the property disposition program, we might argue that there is no incremental cost associated with the use of Section 8. On the other hand, we might take the cost as simply the contract or budget authority value of the units actually assigned to property disposition. In reality, neither approach is very instructive, because much more is at stake here.

We are under an obligation to maintain the low and moderate income character of these projects. Many projects failed in the first instance because tenant incomes did not keep up with spiraling operating costs. This experience has taught us that a tenant-based deep subsidy is essential to the success of such projects. Section 8 provides that subsidy.

We believe this allocation of resources is eminently reasonable and highly cost effective. The housing stock now owned by HUD was produced at 1/3 to 1/2 the cost of building new units today. It is cheaper in virtually every instance to repair that housing and assign Section 8 funds to it than to build new Section 8 units. In addition, where we could dispose of a property without Section 8 subsidy, it would likely be at a lower price, and we would still face the question of how to house the lower income tenants who would be displaced as a result of the sale.

I prefer to view the issue as the Department working to use available Section 8 funds and available physical resources to provide housing for low- and moderate-income families. The property disposition program provides one source of low cost, existing housing to serve this tenant group.

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Recommendation Seven -- emphasize the need to guard against fraud and abuse in the management and disposition of multifamily projects.

We agree wholeheartedly. We are totally committed to this end and, as previous testimony has indicated, are working to improve our management systems to help us to do just this. Once the tools are in place, guarding against fraud and abuse will be much easier.

I would also like to address myself briefly to recommendations first made orally by the GAO in a briefing last Friday afternoon. They dealt with Departmental accounting problems, all of which we are solving -- and Assistant Secretary Medina will speak more on that issue -and more general servicing problems. Once again the analysis and recommendations track our own efforts in these areas and are bolstering our management initiatives already underway to improve our handling of this inventory. I believe our entire plan of management improvements, both those already in place and those still being implemented or developed, responds adequately to GAO's most recent critique of our work.

In that regard I would just like to make the following closing remarks.

The GAO and the Senate staff all looked at various samples of our inventory of over 2,400 projects with HUD-held mortgages or HUD-owned and both staffs turned up particular individual cases which reflected past deficiencies in our management of this inventory.

These individual cases are frequently newsworthy and sometimes reflect unfortunate abuse and mistakes. If that weren't true, if there were no disturbing cases, no deficiencies in our system, we wouldn't have begun to institute the many management changes which we have over the past two years.

We feel very strongly that we are putting the systems in place which will correct the deficiencies, including staff training, management tools, data systems, foreclosure criteria, workout procedures, monitoring for fraud and abuse, better legal support and on and on, and in this fashion we will reduce the opportunities for failure, fraud and abuse to a bare minimum.

With the continued help of Congress and the support of the tenants, industry groups, and other concerned parties, and the continued dedication of the HUD employees committed to this task, we will prevail.

The hearings which you are conducting furnish both an opportunity and a danger. The opportunity is for us to explain what we are doing to remedy a situation that is of grave concern to all of us, to hear your recommendations and conclusions, and to get input from tenants and housing experts around the nation. This process can contribute to and improve our reform efforts. The danger is that if the hearings focus on individual problems and errors, ignoring the progress that has been made, they will leave a seriously misleading impression in the minds of the Congress and the public, undermining the very important work that is continuing to take place. This will serve none of the objectives which we all share.

I will be happy to answer your questions.

## Statement of William A. Medina, Assistant Secretary for Administration, Department of Housing and Urban Development

Thank you for asking me to appear before your Committee. I will direct my remarks to the steps which we have jointly taken with Assistant Secretary Simons to improve the management of the multifamily inventory through staff training, manpower improvements, accounting and automated data processing efforts. My staff has been working closely with Assistant Secretary Simons' program offices to determine what additional support services are needed to address the problems associated with the multifamily inventory.

Since our appointments to the Department, Assistant Secretary Simons and I have been made keenly aware of the magnitude of the problems facing the Department in the management and operation of the multifamily programs. I believe that we have made significant progress in addressing these problems. In the area of automated data processing, for example, we have devoted significantly increased support to the operation and management of HUD's multifamily programs. In 1977 Mr. Simons and I joined in an effort to consolidate the many separate systems - each oriented to one or a few programs - which served HUD's multifamily efforts. The first fruits of this effort, MIDLIS (Multifamily Insured and Direct Loan Information System), will be implemented nationwide within the next thirty days. The system tracks a multifamily project throughout its entire life cycle, beginning with acceptance of mortgage insurance to final disposition. MIDLIS will provide consolidated comprehensive data on all multifamily projects in development and will also track secretary-owned and secretary-held projects. Information will be provided on number and type of projects, age of project, default status, workout agreements, field office site reviews and information. The system will allow better Headquarters oversight of the multifamily inventory and provide field office managers with an additional management tool. Training of field staff in the operation of the system has been underway for some time and the system will be in operation in all multifamily offices in February 1980.

Additional efforts which will provide major operational monitoring of multifamily projects are underway. The OLM system (OLMS) operates in support of the multifamily servicing function at the field office level. This system, is to be completed this fiscal year, will provide a variety of reports which allow the orderly and timely identification of deviations from normal expenses and rents which occur in insured multifamily projects. The system will compare key indicators to local norms for similar properties in similar locations and will flag expense or rental items which should be questioned by the field office program staff. This system will significantly enhance the capacity of loan servicing staff to monitor project operations and to identify problem situations.

In the area of Training, we have been working closely with the Office of Housing to identify training needs of HUD staff involved with multifamily servicing. For several years the Department has sought to identify and solve problems which contribute to the unnecessary degeneration of many insured multifamily projects into "troubled projects." We have studied these problems - sometimes with the help of outside experts -- and have determined that in many cases better trained staff is an important part of their solutions. Last year we broadened our assult on the problems so that while we were improving and expanding our in-house loan servicing course offerings, we were at the same time beginning the development of a comprehensive program to bring the major loan servicing problems under control. Our evaluations indicate that our in-house training has improved considerably and our comprehensive program is well into the development stage. Our major efforts include:

- A project to prepare a total of five modules on Financial Analysis and Management Review of multifamily projects. The first package has been submitted to the Department for review and all components are expected to be used with field staff in FY80.

- A study to produce standardization of loan servicing jobs and functions in field offices, and to modify the work flow for more efficient and effective output.

- A contract to provide a workbook to guide servicers through the analysis of a project with an emphasis on the process of selecting the proper tools for helping troubled projects.

- The development and production of a basic training program for loan servicers which focuses on routine servicing but includes indicators of potential problems. Also, a specialized training program for highly competent advanced servicers is underway.

I should also point out that our programs to training of Housing Division Directors and their Deputies is being upgraded and will include subject matter to better equip the key officials to supervise the loan servicing and property management functions.

In FY 1979, Housing and Administration completed a thorough study of multifamily loan management activities which resulted in new standards for assigning staff to field offices. These improved standards specify the staff time required to perform the various loan management activities such as processing rent increases, analyzing financial statements and conducting on-site management reviews, and take into account recent changes in program emphasis and new management initiatives. The application of these refined standards to rising levels of workload has resulted in an increased allocation of staff-years devoted to multifamily management activities. For example, the multifamily loan management and property disposition staff-year allocation increased from 809 in FY 1978 to 857 in FY 1979 and over 1,000 for FY 1980.

In the area of accounting, a task force has been established with representatives of the Office of Housing and the Office of Administration to implement solutions to problems that have already been identified, including those which the General Accounting Office discussed with us on January 18, 1980. The Housing and Administration group will continue to meet on a regular basis to solve future problems as they arise.

The Office of Administration is responsible for the Departmental accounting systems which maintain the insurance-in-force records, furnish amortization schedules and bill and collect mortgage insurance premiums on all multifamily insured mortgages. On multifamily mortgages which are held by the Secretary, the Office of Administration pays claims to lenders, bills and collects mortgage payments, maintains tax escrows and makes tax payments and invests reserve funds. For Secretary-owned projects, we pay claims to lenders, receive monthly accounting reports from brokers, deposit remittances for excess monthly income over expenses or authorize disbursement for excess expenses over income, pay taxes and major repair expense vouchers and review and process sales transactions. We are taking several steps to improve the financial management of the multifamily programs.

The GAO, for example, expressed concern over the delay which occurs in sending out the notice of the first monthly mortgage payment due HUD after a mortgage has been assigned. The GAO is correct that our policy for many years was to defer sending the notice of mortgage payment due to the mortgagor until we had received the accounting and fiscal data from the mortgagee. This almost always meant that the first mortgage payment notice was not sent until two months after the morgage was assigned to the Secretary. The delay was caused by the 45-day time period allowed in the regulations for the mortgagee to submit the accounting and fiscal data to HUD. These notices should be sent out immediately following assignment. We will require the mortgagee to furnish the amount of the monthly mortgage payment due when the mortgage is assigned to the Secretary. This information will be used to bill the mortgagor until the final accounting data are available from the mortgagee.

Pending the issuance of instructions to lenders to submit the monthly payment data at the time the mortgage is assigned, we will bill the mortgagor for an estimated monthly payment on the basis of information received from the mortgagee with the election to assign the mortgage. This interim billing system will be placed into effect with respect to all mortgages assigned after February 1, 1980.

GAO has stated that monthly mortgage billings are being sent out late across the board to mortgagors. We researched the records in the Office of Finance and Accounting and determined that 2,036 mortgage payment notices were issued for June 1979 payments. Of this number, 1,898 were sent prior to May 29, 1979 and the remaining 138 were sent prior to May 31, 1979. According to our records, mortgage payment notices for most cases are sent out before the first of the month. There have been exceptions for some cases. However, since we obtained word processing equipment for this function in August 1978, our record for sending out monthly mortgage payment notices has improved greatly over performance when the function was performed manually. If we understood correctly, GAO stated that field office copies of the notices for mortgage payments due June 1, 1979 were not received in the Loan Management Branch of the New York Area Office until July 2, 1979. As indicated above, the notices to the mortgagors were dispatched prior to June 1st. The field office copies of the notices should be promptly sent to the Loan Management Branch, at the same time that copies are sent to the Headquarters program office.

We are in the process of enhancing our word processing system and have set a goal to have bills for all mortgage payments issued by the 20th of the month prior to the due date. We expect to attain this goal by June of this year.

Procedures are being developed to reconcile the Headquarter's Accounting Office inventory of Secretary-held multifamily mortgages and properties with field office records. The first reconciliation will be completed by March 31, 1980. The Department has performed such reconciliation on single family properties and mortgages because of the volume of these cases. Due to the increase in multifamily activity we are now initiating similar reconciliation procedures for the multifamily program.

GAO has stated that the servicing of mortgages by field office loan servicers has been adversly affected by the misdirection of the monthly mortgage payment notices to incorrect field offices. The misdirecting of these notices did occur in some instances following the Department's reorganization of field office functions and the shifting of multifamily functions from insuring offices to area offices. The error occurred when the Accounting Office records were not updated to show the transfer of the multifamily cases from the insuring office to the area office. When we discovered this error, we corrected it immediately in June 1979. To our knowledge, no misdirection of statements has occurred since.

Tax escrow accounts on all mortgages are being analyzed in order to assure that our records are current. This analysis will be completed by March 31, 1980 and all project accounts will have been adjusted by that time. We are also installing a revised monthly mortgage billing system with recently acquired word processing equipment. The new system will provide positive tracking over the process of obtaining tax bills timely so that payment can be made without penalty. We are also making the field offices responsible for reviewing tax authority records to determine all types of taxes due and for obtaining the tax payment notices. GAO has stated that field offices should have the responsibility for dealing with tax authorities. This decentralization should eliminate the under and overpayments noted by GAO. The new system will also enable us to mail the monthly mortgage payment bills out by the 20th day of each month and enforce the assessment of late charges for mortgagors that do not make their monthly payments on time. In this regard, we are working with the Office of Housing toward development of a consistent policy for the assessment of late charges.

The Office of Housing is working to bring all mortgages in default under workout agreements. The Accounting Office has developed procedures to provide timely feedback information to field offices and to the Office of Housing on the status of the workout agreements so that the mortgagor's performance can be monitored on a regular basis. The new procedures are a part of our revised billing system and will be in operation by June 1980.

Our word processing equipment is being reprogrammed to interface with Housing's MIDLIS system and provide daily information on the payment status of mortgage note accounts to loan servicers in HUD field offices. It is our plan to have the word processors programmed to provide this accounting data to the MIDLIS system by June 1, 1980.

In summary, I believe that we have taken and are taking major initiatives to address the problems associated with multifamily servicing and we expect to pursue these efforts until all problems are resolved. I would be pleased to answer any questions.

## Letter From Lawrence B. Simons

MAR 21 1980

Honorable William Proxmire
Chairman, Subcommittee on HUD-
Independent Agencies
Senate Appropriations Committee
United States Senate
Washington, D.C. 20510

Dear Senator Proxmire:

At the hearings on January 23, 1980 of your Subcommittee on HUD and Independent Agencies of the Senate Appropriations Committee, you requested that the Department provide for the record a timetable for the implementation of the reforms in the management of HUD's multifamily inventory and a bimonthly report on our progress in meeting that timetable.

I am enclosing with this letter the timetable you requested for inclusion in the record of these hearings. It is presented in the format we plan to use for the bimonthly reports.

As you will recall, when this Administration took office in 1977 we committed the Department to taking long-term responsibility for the successful operation of our multifamily housing projects. We embarked on a major review of the management and operation of the housing we produced and, subsequently, began a comprehensive effort to respond to the deficiencies we noted in that review. The results of that review and the corrective plan of action we are implementing in response to it are well documented by our own reports, prior testimony before this and other Committees of Congress, the General Accounting Office, our own Inspector General and most recently, the series of hearings begun in November by your Subcommittee on Appropriations.

What has emerged from this is a clear understanding of the task to which we are all committed: improving the entire scope of our management of multifamily housing from the routine monitoring and project servicing of successful projects, through the difficult and complex servicing of troubled projects, and ultimately to the management and eventual sale of seriously distressed projects which the Department acquires. Each part of this process has come under scrutiny. Each improvement we have identified in this report is a piece of the larger undertaking to create a more appropriate and, ultimately, more successful management effort.

The report I am submitting with this letter is organized along the same lines which we have organized our thinking and efforts in this area; namely, our management operations through the entire project life cycle. It begins with those initiatives we are taking to improve our routine project monitoring and servicing, including our general management changes in the areas of data systems, personnel management, and organization. This is where we perform our basic management function: reviewing management performance, conducting physical inspections, analyzing financial statements and generally assuring program compliance. Included in this is managing the HUD organization as well as overseeing the management of projects. Built into this phase is our capacity to identify those projects which are in distress of one form or another -- with physical, financial or management problems. Once identified, these projects are flagged for more intensive servicing.

Our next category of changes are those we are undertaking to increase our ability to deal with those troubled projects. Obviously, many of the changes aimed at improving our overall management of the inventory will prove beneficial at this stage as well -- such as increased capacity for financial analysis, but others are targeted specifically at the smaller subset of distressed projects. This is where we emphasize more detailed project analysis and aggressive servicing, and where we are working to improve our ability to bring problems to a resolution quickly, such as through a speedier foreclosure process. It is also the stage where we must work hardest to assure financial accountability in project operation and to assure that the tenants and the neighborhood are not affected adversely by a deteriorating living environment.

At this stage we are able either to work out a project's problems in partnership with the private sector or, failing that, move to foreclose and acquire the project so that its problems can be remedied directly by the Department. If we have to acquire a project, a different set of concerns and issues needs to be addressed.

Our remaining series of management improvements fit into place at this stage. They are related to our management of these projects during HUD ownership, including better financial accountability and maintenance, and our policies and procedures for assuring that the projects are used to provide the housing resources for which they were originally constructed.

Once repaired and returned to the private sector, these projects again became subject to our normal servicing activities including, if necessary, more intensive efforts for those which may return to the troubled category.

It is through the totality of our managment improvement approach that we will better discharge our responsibilities in our multifamily housing programs. Each change is an integral element of this comprehensive restructuring of our efforts, but the critical element is our attempt to address the full range of the management problem. We believe the key to success lies in this philosophy. A piecemeal, reactive strategy has severely limited prospects for succeeding when the problems are so general and widespread. I believe our efforts to date have been fully consistent with our need to resolve these housing management problems.

I share with you your concern in this area and appreciate the interest and assistance you have given us. Let me assure you of our continued cooperation in tracking our administrative activity in this area. Once again I would like to reiterate this Department's unqualified commitment to improving our performance on these issues. I believe much has been accomplished up to now, but still recognize that much more remains to be done.

The continued support of the Congress and your Committee will be of tremendous assistance in finishing the job. I will forward copies of this timetable and our bimonthly reports to Senator Mathias, Chairman Williams, Senator Garn, Chairman Boland, Chairman Ashley, Congressman Stanton and Congressman Coughlin in order that they might also be kept apprised of our activities in this area.

Sincerely,

Lawrence B Simons

Lawrence B. Simons
Assistant Secretary

Enclosure

## Explanatory Note

The list of improvements is divided into three categories reflecting the three major stages in the management of the multifamily inventory: project monitoring and servicing, troubled project servicing and management of HUD-owned projects. Each category is subdivided into discrete actions.

Each action is identified briefly followed by a date or dates of major measurable milestones in completing the action and a comment section. If delays in implementation are encountered, they will be reported in this section. The reports referenced in the comments section are the Senate Appropriations Committee Investigations Staff Report No. 79-10, November 1979 (Senate staff report); the Comptroller General's December 19, 1979 Report on the Management of Acquired, Formerly Subsidized Projects; (CED-80-31)(GAO HUD-owned report), the Comptroller General's Analysis of Multifamily Assigned Mortgages January 16, 1980 (CED-80-43) (GAO letter report) and the General Accounting Office's prepared statement of January 23, 1980 on HUD's Accounting System for Secretary-held Multifamily Mortgages (GAO HUD-held report).

### Timetable for the Implementation of Improvements in the Department of Housing and Urban Development's Management of Its Inventory of Multifamily Housing Projects

## I. Project Monitoring and Servicing

1. ACTION: Remote monitoring of field office performance indicators.

   DATE: Develop initial system - May 1980
   Fully operational - July 1980

   COMMENT: A more systematic review of field office performance will enhance individual project monitoring, a weakness which both the GAO and Senate staff reports described.

2. ACTION: Management review requirements.

   DATE: Develop review materials - Completed
   Communicate to field - Completed
   Fully operational - Completed

COMMENT: Troubled projects (subsidized or unsubsidized) receive annual comprehensive reviews; untroubled subsidized projects receive annual limited reviews and untroubled unsubsidized projects are reviewed biannually. These actions are monitored through the Operating Plan to assure that all projects are reviewed. This process should enable us to prevent past problems where projects went for too long a time without attention. It will also enhance our ability to respond quickly when a project mortgage is assigned to the Department.

3. ACTION: Blend eligibility requirements for Rent Supplement, Section 8 and Rental Assistance Payments (RAP).

DATE: Develop forms and materials - June 1980
Communicate to field - August 1980
Fully operational - September 1980

COMMENT: This will help make income verification an easier job and assist in preventing fraud and abuse, a speciic Senate and GAO concern.

4. ACTION: Training in occupancy matters.

DATE: August 1980

COMMENT: Training will stress uniform eligibility and income verification procedures and assist in preventing fraud and abuse.

5. ACTION: Regulatory Agreement
DATE: Issue revised agreement - October 1980
COMMENT: A strengthened regulatory agreement along with aggressive enforcement will increase our capacity to recover diversions of rental income, a GAO HUD-

held report concern, and take control of projects whenever that is warranted, a GAO letter report concern.

6. ACTION: Management agreement

DATE: Develop revised agreement - July 1980
Communicate to field - September 1980

COMMENT: A revised standard agreement will increase our control over poor management in HUD-owned and insured and assigned projects.

7. ACTION: Modular financial analysis course.

DATE: Develop course and produce materials - October 1980
Distribute materials to field - December 1980

COMMENT: This is a packaged course being developed by an independent contractor which could be taught in the field office by more experienced loan management staff. Improved capacity for financial analysis, recommended by the GAO in its report on HUD-held accounting, will greatly assist field staff in project monitoring in general, a weakness noted by the GAO and the Senate staff report.

8. ACTION: Comprehensive review of the Loan Management function in the field and recommendations for organizational changes.

DATE: Final report - October 1980
Begin implementing recommendations - FY 1981

COMMENT: An independent contractor is undertaking this major functional analysis, which was begun in January 1980 and follows up on prior contract work.

Data Systems

9. ACTION: Multifamily Insured and Direct Loan Information System (MIDLIS).

DATE: Initiate the system - March 1980

COMMENT: MIDLIS will be our principal multifamily project information system. It will permit HUD to track major actions on each project through its entire life cycle and give Headquarters a better capacity to monitor field performance. The importance of such a system was recognized by both the GAO letter report and the Senate staff report in their calls for better project data. MIDLIS will also increase our capability to monitor the submission of financial reports, a criticism in the GAO HUD-held report.

10. ACTION: Office of Loan Management System (OLMS).

DATE: Basic system

Fully loaded - June 1980
Fully operational - July 1980
Issue users guide - September 1980

Enhanced System

Planning - March - May 1980
Design - (not set)
Programming - (not set)
Operational - (not set)

COMMENT: This system will provide HUD with basic comparable project operating cost data vital to project monitoring and expenditure analysis. The GAO HUD-owned report noted the need for such information.

II. Troubled project servicing

1. ACTION: Workout analysis procedures and criteria.

DATE: Interim Notice on analysis techniques, forms, and procedures for workouts - April 1980
First draft of contractor product delivered - July 1980
Issue workout workbook and detailed follow-up instructions - December 1980

COMMENT: This product will be a major working document in troubled project servicing. It will include criteria which would lead to a decision to foreclose. This work is critical to a speedy process of putting projects under an approved plan, a need noted by both the Senate staff and the GAO.

2. ACTION: Improved system for tracking foreclosure actions.

DATE: Develop model with Department of Justice - May 1980
Develop tracking system - June 1980
Coordinate implementation with field offices, Department of Justice - July - September 1980
Fully operational - October 1980

COMMENT: A better monitoring system should lead to shorter internal processing and speedier foreclosure, a need recognized by GAO and the Senate staff.

3. ACTION: Goal of 90% of HUD-held projects under an approved plan.

DATE: Achieve goal in each Region - September 1980

COMMENT: Status as of January 31, 1980

| | | | |
|---|---|---|---|
| Region I | 64% | VI | 82% |
| II | 67% | VII | 85% |
| III | 70% | VIII | 89% |
| IV | 87% | IX | 90% |
| V | 72% | X | 94% |

This goal is our principal management tool in bringing projects under an approved plan quickly. This concern has been expressed by both the Senate staff and the GAO. A project is under an approved plan if it has a workout agreement, is current under the terms of its original mortgage or has been recommended for foreclosure.

4. ACTION: Foreclosure process improvement, including earlier possession to speed foreclosure.

DATE: Develop model legal complaint to secure earlier possession - April 1980
Communicate to field and Department of Justice - May 1980

COMMENT:

5. ACTION: Secure statutory authority for faster foreclosures.

DATE: Legislative approval - September 1980
Implementation - February 1981

COMMENT: This problem has been properly highlighted by both GAO and the Senate staff and we anticipate Congress' continued cooperation in resolving it.

6. ACTION: HUD-IRS Reporting System

DATE: Develop system - August 1980
Fully operational - October 1980

COMMENT: IRS retains the responsibility for enforcement of tax consequences but improved cooperation will be beneficial and help to remove one incentive for delay noted by the GAO letter report.

7. ACTION: Secure relief from provisions of the Bankruptcy Code which threaten multifamily projects.

DATE: Legislative approval - September 1980

COMMENT: The GAO and Senate staff reports criticized delay in the foreclosure process. A narrow exemption from the new code for multifamily mortgages will be very valuable in avoiding future delays.

8. ACTION: Reconcile multifamily inventory in field with Headquarters.

DATE: Develop procedures - Completed
First reconciliation - April 1980

COMMENT:

Accounting Systems

9. ACTION: Automated billing reflecting workout agreements with reports to field offices through MIDLIS.

DATE: Develop system - April 1980
Implement change - May 1980
Fully operational - July 1980

COMMENT: This change will permit more aggressive servicing in HUD-held projects and the need for it was noted by the GAO in the HUD-held report. It will provide servicers with adequate collection information.

10. ACTION: Interim billing of mortgagors immediately upon assignment of mortgages.

DATE: Develop new interim billing procedure - March 1980
Fully operational - April 1980

COMMENT: This procedure will help to shorten the time frame within which we deal with assigned projects and initial workouts. The GAO expressed concern over our timeliness in this area.

11. ACTION: Timely billing on assigned mortgages - 20th of the month prior to due date.

DATE: Enhance word processing system - May 1980
Achieve goal - June 1980

COMMENT: Timely billing will give servicers another tool with which to be more aggressive in their approach to servicing HUD-held projects. This was an item which the GAO HUD-held report found.

12. ACTION: Tax escrow accounts for assigned mortgages.

DATE: Complete analysis and adjust accounts - March 1980

COMMENT: The GAO HUD-held report reflects the Department's concerns that this issue be resolved.

III. Management of HUD-owned Projects

1. ACTION: Improve financial management and reporting.

DATE: Develop procedures and materials - June 1980
Communicate to field - July 1980
Fully operational - September 1980

COMMENT: The GAO HUD-owned report was especially critical of this problem which the Department is committed to remedying.

2. ACTION: Blend management procedures and requirements for HUD-owned projects with those for HUD-held and insured projects.

DATE: Develop procedures and materials - July 1980
Communicate to field - August 1980
Fully operational - September 1980

COMMENT: This change should standardize and improve project monitoring in our HUD-owned projects, a weakness that both the Senate staff and GAO related in their reports.

3. ACTION: Final rule on disposition of HUD-owned projects.

DATE: Publish final rule - July 1980

COMMENT: This rule addresses tenant participation, repair and preservation of the low and moderate income character of projects as well as all other aspects of the disposition process. An interim rule is presently in effect.

4. ACTION: Advanced training course on management and disposition of HUD-owned projects.

DATE: March 1980

COMMENT: This course was given at the HUD training center in Columbia, Maryland the week of March 10 - 15.

5. ACTION: Basic training in contracting and reconditioning for HUD-owned projects.

DATE: October 1980

COMMENT:

6. ACTION: Basic training course on management and disposition of HUD-owned projects.

DATE: October 1980

COMMENT:

7. ACTION: Advanced course in contracting and reconditioning for HUD-owned properties.

DATE: December 1980

COMMENT:

8. ACTION: Revise work measurement standards for HUD-owned property disposition activity.

DATE:
Plan study - April 1980
Conduct study - May - July, 1980
Incorporate in FY 81 OPLAN - August 1980

COMMENT: A major Loan Management work measurement study was completed in the fall of 1979 and is reflected in the FY 80 Operating Plan. Accurate work measurement standards is the first step towards providing adequate staffing, a deficiency noted by the Senate Staff report.

### PROBLEM PROJECTS

Senator PROXMIRE. Mr. Secretary, as you know, a major reason for this hearing is to determine whether the difficulties illustrated by Clifton Terrace are widespread or are unique to that project. Consequently I would like to start my questioning today by asking about specific problem projects—projects cited by FHA Tenants United and the General Accounting Office here today and also mentioned in the report of the committee's investigations unit. I understand that the subcommittee staff gave you a list of 24 projects that might be the subject of questions. They gave you that list last Friday. Of course, a number of projects were mentioned in the investigations staff report which came out in November.

We will then go on to some more general questions.

First, I understand the potential diversions of $2.7 million from the Delano Village projects mentioned by GAO were clearly visible within the 1974 through 1978 financial statements of these projects. Why did it take 5 years for HUD to uncover them when servicers are required to review the financial statements?

### SCOPE OF THE PROBLEM

Mr. SIMONS. I will respond to your question shortly. We were presented with these 24 cases on Friday and we have made an effort to get some information with respect to all of them. We will provide you with detailed answers for the record on anything I may not satisfactorily answer.

I think when we look at a situation in a case such as Delano Village, we are looking at the entire scope of the problem and how to deal with it. First, I have to put it into the perspective of where we are on a program level. We deal with 17,000 multifamily projects, providing housing for about 1.7 million families and having a rent roll of approximately $400 million a month. That is the scope of the problem. It is a huge problem. We have tremendous successes, but I think this hearing, properly so, is focusing on those projects which are the troubled projects. The general problems we are talking about were exacerbated and accelerated in a very narrow period of time, 1974–76, by what happened in the real estate industry and the general economic picture of this country, which, with the energy problems, compounded a tremendous problem for the Department to respond to within a very short period of time.

The problems that we have been dealing with and which have been the subject of hearings we had in December and today are problems that were exacerbated in that period. Nevertheless, the Department has the responsibility for responding to those problems. We have responded to them so far, as you pointed out, with an entire reorganization of the Office of Housing and the field offices, and improvement of our policies and training. The eventual implementation of these changes at the area office levels will determine if the job has been done properly.

There are cases out there that have been neglected. However, the Delano Village case shows we are on the right track and the systems that will be in place in 1980 will prevent a Delano Village situation from happening again. Interestingly, in the Delano Village case, the area manager, who reported to New York in 1977, requested an Inspector General audit of his loan servicing operation. As a result of that audit, major changes were made in the way they manage the loan servicing effort. Through their own efforts, the Delano Village situation was brought to light and they referred the situation to the Inspector General——

### DELANO VILLAGE

Senator PROXMIRE. Let me ask that question again because I think I probably didn't put enough emphasis on it. Why did it take 5 years for HUD to uncover these problems when servicers are required to review the financial statements?

Mr. SIMONS. The simple answer is that there is no excuse for not discovering such a situation. The problem is one that results from what was an endemic situation that was found at that time, a huge workload of cases, some of them being neglected, no question about that. We found that out ourselves. There was a need to look at the whole loan servicing operation to insure this would not happen again.

Senator PROXMIRE. The problems we are discussing today were uncovered, as I understand it, by a handful of auditors, five or six, over a period of about 6 months——

Mr. SIMONS. Mr. Chairman, I would beg to disagree. I think the problem of Delano Village was discovered by the area office. It has been highlighted by the audit. In February of 1979, that case was referred to our own Inspector General.

Senator PROXMIRE. I also understand that, although the diversions were uncovered in February–March 1979, they were only recommended for foreclosure and referral to the Department of Justice in November 1979. Why the long delay?

Mr. SIMONS. That most likely resulted from the negotiation and further investigation going on by the Inspector General to build a case. I will be happy to give the details of what happened for the record.

Senator PROXMIRE. Give that information to us for the record.

[The information follows:]

### MORTGAGE REINSTATEMENT SOUGHT THROUGH NEGOTIATIONS

The diversions were identified by staff in the New York area office in early 1979 as part of a reorganization effort in the Loan Management Branch. In February, the Office of the Inspector General was requested to conduct an audit. During this time the area office was meeting with the owner to demand payment of diverted funds and negotiating with the owner over reinstatement of the mortgage.

In April, the Inspector General completed its review which supported the area office's findings. Through the summer, the area office continued to meet and negotiate with this owner in good faith in hopes of being able to have the mortgage reinstated and to recover funds. When the area office began this series of negotiations, it was not a foregone conclusion that foreclosure would be the only remedy. Only after negotiation appeared to be a fruitless path was a foreclosure recommendation made by the area office.

Senator PROXMIRE. The mortgagor has informed GAO that the Delano Village diversions were approved by HUD. What is your response to that?

Mr. SIMONS. To my knowledge, they were not. I understand there were supposed to be oral communications. There is nothing written in the file to show——

Senator PROXMIRE. But oral approval could have been given without a notation in the file.

Mr. SIMONS. None of us can be sure what people say to one another.

Senator PROXMIRE. At any rate, you have researched that file carefully and there is no written evidence of approval.

Mr. SIMONS. My people inform me there is no written evidence.

Senator PROXMIRE. GAO has indicated to the staff that a summer intern reviewed the financial statements of the five New York City projects handled by Carol Management Co. Why was a summer intern used?

Mr. SIMONS. I cannot answer that. A summer intern might be a very competent person.

Senator PROXMIRE. I realize that. Some of the best people I have had working for me were summer interns.

Let me say that the subcommittee staff specifically requested that you have representatives from the New York office at the hearing so we could discuss these projects with them. Are Mr. Foy and Mr. Springer here?

Mr. SIMONS. They are.

Senator PROXMIRE. Maybe they can tell us why a summer intern was used?

### AREA OFFICE RESPONSE

Mr. FOY. I am Donald Foy, Chief of Loan Management, in the New York area office. The gentleman in question had a graduate master's degree in accounting. No one on my staff had any background in accounting capable to evaluate such a huge operation, and so I assigned him to that job. And he discovered certain things before he had left after the summer. We have since done many things in reference to those——

Senator PROXMIRE. Let me interrupt to ask why you have that staff deficiency. Shouldn't you have somebody on your staff who is capable of auditing these projects, somebody with an accounting background?

Mr. FOY. This is one of the changes that has come about, as Mr. Simons has outlined.

Senator PROXMIRE. When did that change occur?

Mr. SIMONS. They are in the process of seeking to fill four positions in that office with people with an accounting background.

Senator PROXMIRE. I understand that your summer intern had a degree from the Wharton Business School. I have great respect for Wharton, although I am a Harvard Business School graduate. I think Wharton is pretty good. It is No. 2.

I recall when they used to laugh at business school graduates because they were called masters of business administration. All we had was a little academic training and no experience at all. This young man, I am sure, was a fine young man with a fine educational background, but without, apparently, more than a week or two of any solid, practical experience in the field. We all know you learn about 95 percent of what you learn in any endeavor when you get on the job. You don't learn it in school.

### LOAN SERVICER'S FUNCTIONS

Mr. SIMONS. Mr. Chairman, without differing with the implication of your question, I think it would be helpful if there was an understanding of just what is loan servicing. This is the function of a loan servicer—the person who reviews perfunctory statements, looks at the regular statements, and looks for what are considered deviations. To take the balance sheets for a multimillion dollar corporation and to analyze those balance sheets, was something we decided we cannot do at the loan servicer level. We need people trained as financial experts, such as this young man with his MA. Anybody who is trained in the accounting and auditing field can look at balance sheets and understand deviations and problems raised by those balance sheets. An accountant will tell you a balance sheet is a balance sheet. One of the problems we had is we did not understand there was this type of sophistication necessary to deal with those very large projects and very large project owners. We are bringing that into the Department and training those people. I think the record speaks for itself in this case because this young man seems to have discovered things that were not discovered in that office before.

### CAROL MANAGEMENT PROJECTS

Senator PROXMIRE. I don't know if it speaks well for him although, as I say, he is probably a fine young man, because the work had not been done competently before at all.

The GAO also indicated the team captain responsible for four of the five Carol Management projects had recommended that the Inspector General be brought in to audit the projects because he believed he did not have an adequate accounting background to handle them. However, instead of approving the recommendation, the branch chief assigned the projects to another servicer, who also lacked a technical background in accounting. I understand this servicer then asked for GAO's advice and asked GAO to sit in on discussions with the accountant. Why were these projects not referred to HUD's auditors, especially since a detailed analysis by the summer intern—with an accounting degree from the Wharton School—revealed various questionable items and deficiencies in the statements?

Mr. SIMONS. I could not answer that.

Senator PROXMIRE. Can the New York people answer that question, Mr. Foy?

Mr. FOY. Some of the jobs in question were in foreclosure back to 1977. On one of the other jobs, River Terrace, myself and the Deputy Director were trying to work out a plan to put together with the people from Carol Management and their lawyers, and we worked with them very closely. It came about they gave us a check last week for $423,000 to pay off the interest. We are still working with them and have not accepted any sort of workout agreement with them.

Another job was not a HUD-held job they were looking at, and that particular job——

Senator PROXMIRE. Let me interrupt. I don't know how you could negotiate with these people if you didn't know what the facts were.

Mr. FOY. We knew the facts on the individual job. We knew that they had arrearages and they would bring the arrearages current. In any sort of negotiations, there has to be a certain amount of give and take.

Senator PROXMIRE. But the books were improper.

Mr. FOY. We did not know the books were improper. Before we entered into any firm negotiations, I assigned it to a man, a loan servicer, who had worked on other recasting jobs.

Senator PROXMIRE. The only investigation was made by your summer intern, as I understand it—correct me if I am wrong—and that investigation indicated there were deficiencies and questionable entries.

Mr. FOY. There were, and we asked Carol Management to explain those. Two of the jobs were in foreclosure. It was the policy of our office that when the Justice Department asked if there were any diversions of cash, we asked our Audit Department to go in and do a complete audit. We have changed that. Now when we ask for foreclosure, we are asking the Inspector General to go in and do an audit.

## COMMINGLING OF PROJECT ACCOUNTS

Senator PROXMIRE. Mr. Simons, after discussing the results of their audit with New York area office officials, GAO was told by these officials that the commingling of project funds with other HUD-insured and non-HUD properties and the failure to maintain separate financial records were not serious issues. Do you agree with that?

Mr. SIMONS. Let me say this, the question of commingling can be a very serious issue and generally is. As I understand it in this case, we are dealing with an owner who had a multitude of projects and a number of projects which were insured by us. I do not support commingling, but I think the issue is not commingling. The issue is whether there are books and records available which will indicate the audit trail for each individual project.

Senator PROXMIRE. But doesn't the commingling of project funds lead to the possibility of improper diversions which can be easily hidden from detection?

Mr. SIMONS. If there is a proper audit trail, it does not. However, it is in the handbook and it is in violation of the handbook.

Senator PROXMIRE. In this case, there was no proper audit trail, according to GAO.

Mr. SIMONS. That I don't know. There may or may not have been. I understand the audit is still going on. The last I heard there may be proper audit trails.

Senator PROXMIRE. You say there are circumstances under which the HUD regulations on commingling can be violated?

Mr. SIMONS. An action which is not in conformance with the regulations or handbook is in violation of them. When that happens, they are violated. In this case, apparently, permission to commingle was given many, many years ago because they were trying to encourage additional investments in order to save these projects and it indicates perhaps the method by that office at that time to preserve these projects from default and help these tenants and try to maintain these as adequate, proper, and sound projects. That, I understand, happened many years ago.

## DIVERSIONS OF FUNDS

Senator PROXMIRE. GAO has indicated that in a March 1979 report by the regional inspector general for audit on his review of the New York area office Multifamily Loan Management Branch the Inspector General found potential diversions and improper disbursements of $120,000 by Twenty-One Hundred, Inc., and $20,000 by Hinsdale Street Rehabilitation.

GAO has also indicated that HUD's New York area office only recently, in December of 1979, after a meeting with GAO on the issue, requested that HUD headquarters have the Department of Justice follow up the $120,000 item and there was no evidence of any further action on the $20,000 item.

Why the delay in requesting that Justice pursue the funds?

Mr. SIMONS. I am not familiar with those cases and will be happy to provide the record with answers.

[The information follows:]

The alleged diversion at Hinsdale Street rehabilitation involved an excessive management fee taken by the managing agent of the property. The area office made oral demands on the agent for return of the funds, but no money has yet been recovered. Subsequently, HUD took possession of the project, fired the management agent, and is no longer accepting its participation in HUD projects.

### AREA OFFICE RESPONSE

Senator PROXMIRE. Does the area office have any information on those situations, Mr. Foy?

Mr. FOY. In reference to the $120,000, when that first was discovered there were many attempts by the owners to come in and work out a deal in order to get the job back into the mainstream so they could get a workout agreement. We refused to accept any workout and asked them for the $120,000 up front. This is a case in point as I was saying before. In the past when Justice prosecuted a foreclosure and we were asked were there any diversions, we then asked our Audit Department to do an audit. If there was any diversion likely, we would advise them to enter a civil suit against the mortgagor in order to get our money back. This is what we did in this particular case.

### COMPLEX NATURE OF TROUBLED PROJECTS

Mr. SIMONS. Mr. Chairman, if I could make a comment on these cases. As you know, the various investigative teams which moved around the country to a number of our some 43 field offices with multifamily management responsibility have identified dozens of individual, particular cases in our 2,000-plus project inventory where they think they found something out of order, some inconsistent or irregular behavior, absence of a workout agreement, or a particularly high delinquency.

In many instances, they may have pinpointed one aspect of what would be a fairly highly complex case. In others, they may have uncovered a record of inadequate or unsuccessful servicing. Each of these troubled cases typically has a long history and a very thick file to go along with its prima facie appearance as a complicated case. It becomes very difficult to answer the specific questions directed to these, in light of this type of situation. Whether you feel it is productive or not, we would be very happy to go into the specifics and give you the proper response for the record. There are too many complexities in each of these cases to use this forum to try and answer these questions in the full context they should be answered.

Senator PROXMIRE. I appreciate that. You always have a problem, especially with a huge department, a huge Government, and a huge country. Your response to anything we pick up can be: "Well, that's not typical, that is just a little different." We have to discuss specific examples. We cannot just look at the issues globally. It is the specific instances that give meaning to what we are talking about. I think you realize that we have to bring up specific projects in Chicago, New York, Washington, and elsewhere so that we can have some real understanding of the overall problem. It becomes human then.

Mr. SIMONS. We agree with that concept, Mr. Chairman, and we found that very helpful in our activities in this area.

### METHUNION HOMES

Senator PROXMIRE. Enclosure I of the GAO report notes that Methunion Homes in Boston has a mortgage delinquency of $1.5 million and is 63 months delinquent on its mortgage payments. I understand that in addition to this amount, the project also had a negative miscellaneous escrow balance of $1.4 million as of September 30, 1979. In essence, HUD has used the general insurance fund to make loans to this project for such items as repairs, security, and utilities.

Is it a normal practice to make such advances for repairs, utilities, et cetera, on assigned mortgages, particularly ones which have no workout arrangement and which are not in foreclosure?

Mr. SIMONS. Mr. Chairman, the Methunion Homes is the subject of a demonstration program between CHPA, a local community organization, and the Department, of trying to develop techniques for dealing with troubled projects with community-based organizations and tenant involvement. This is being carried on as a demonstration program and does not represent the typical policies of the Department with respect to the payment of the interest and other items. It is not being handled by normal practice.

Senator PROXMIRE. I have some other questions on that project for the record.

### FHA TENANTS UNITED ALLEGATIONS

I would like to ask you a few questions about abuses cited in the information supplied by FHA Tenants United here today. The first project I would like to question you about is at 4550 North Clarendon.

According to the material, HUD approved a 12-percent rent increase for this property, allowed the owners' agent to defer the payment of more than $3,000 per month to the reserve for replacement fund, and allowed a deferral of principal payment for a 12-month period at a time when one of the owners had improperly diverted $125,000 in project income into a personal loan. This improper loan was apparently not fully repaid until these concessions had been approved by HUD. Why did you permit the owners to avoid their legal obligations and increase rents at a time when project income was being improperly diverted?

Mr. SIMONS. I will get a specific response for the case.

Let me just say this to you, Mr. Chairman. With respect to the testimony of FHA Tenants United, and I think they present some very interesting aspects of the tenants relationship with the projects in which we are involved, one thing they do demonstrate is the process which we have put into effect, which is giving the tenants an opportunity to comment on rent increases and giving them access to the landlord's documentation in support of those rent increases. It has given us an added tool in the proper policing of rent increases. We welcome their input in these areas.

### STANDING OF TENANTS TO SUE

Senator PROXMIRE. I wonder about that. Recently the U.S. court of appeals in Boston held that the tenants in HUD-subsidized housing projects had no right to sue the owners for alleged illegal and criminal acts under HUD's statutes and regulations. It also held that HUD's failure to take corrective action regarding these activities was not reviewable by the courts. Obviously, the court was urged to these conclusions by HUD. Moreover, it has been brought to my attention that HUD's lawyers are using this precedent to argue in other courts that HUD's monitoring of projects is immune from judicial scrutiny. Given the fact that money is being wasted and projects are deteriorating as a result of HUD's failure to manage and monitor not only the insured stock but the assigned stock as well, it seems to me that HUD should be doing everything within its power to encourage tenants to assert their grievances. Can you explain why the policymakers at HUD have failed to instruct the agency's General Counsel that the decision in the Boston case is not to be used to shield HUD from judicial oversight?

Mr. SIMONS. First of all, I am not in a position to comment on the Department's position in the lawsuit. I would like to comment on the subject generally. I think you raise some interesting issues and I think I would like to give you my personal views as to the way I see the issues which you are raising. Tenant participation in the process is a very important element to have the process work successfully. I don't think the Department is in a position of delegating to the tenants, the landlords, or to the courts any single part of our responsibility for making the administrative judgments. After we have received all facts and input from all the interested parties, the responsibility for that administrative judgment is this Department's. I don't think it should be relieved from that. To do so would create chaos in a process that must be very orderly, very timely, and responsive, because whether rent increases are deserved, or if they are not deserved, they must be dealt with in a timely way. The interests of all these parties are not the same, unfortunately. This is the real world and the Department has the responsibility as the administrator to take into consideration all the factors, to be sure it knows all the facts, and to make a reasonable judgment.

It is my opinion, and I am not the lawyer in this case and I don't purport to be the lawyer, that any decision rendered by the Department within its administrative purview is subject to normal judicial review under the Administrative Procedures Act. I don't think that that case says the Department is not subject to that type of review. In fact, as I read a Supreme Court decision 2 weeks ago, I don't think we are exempt from review for actions which are arbitrary.

Senator PROXMIRE. What causes me concern is the picture that emerges from that decision of HUD's treatment of the tenants' complaints. You described the decision correctly. Our position is the tenants should have the power to require the project managers and the Department itself to enforce its own regulations.

Mr. SIMONS. I appreciate knowing your position, Mr. Chairman.

Senator PROXMIRE. Tenant review should help you. It would seem to me that you, particularly, Mr. Simons, and your whole Department has a clear obligation to tenants. That is why we are conducting these hearings. The tenants are the ones who should be the beneficiaries of your assisted housing programs.

Mr. SIMONS. We both recognize that.

Senator PROXMIRE. But it seems to me that if this decision is going to be used by HUD to frustrate effective protest by tenants, it contradicts that obligation.

### TENANT PARTICIPATI'ʼN PROVIDED FOR

Mr. SIMONS. I would think the action of the Department indicates, from a policy standpoint, that we are not using that decision as a shield.

As I pointed out, we have promulgated regulations, and they are in effect now, that on rent increases the tenants are entitled to notice and participation in that process. We also have out for comment tenant participation regulations for our subsidized projects. The area of to what extent there should be tenant participation in the management and oversight of these projects is one which we think is properly handled in the regulatory process, and we are doing that.

Senator PROXMIRE. Let me ask this question again, because I am not sure I got an answer. Why did you permit the owners of 4550 Clarendon in Chicago to avoid their legal obligations and increase rents at a time when project income was being improperly diverted?

Mr. SIMONS. I will have to answer that for the record.

[The information follows:]

In June of 1977, when the rent increase, the mortgage modification, and the deferral of payments to the replacement for reserve were granted, HUD was unaware that the money had been diverted for the personal loan. This diversion was not reflected in the monthly accounting statements received from the owner.

The area office was notified of the loan in question through the findings of an Inspector General's audit on October 28, 1977. The owners were able to demonstrate to HUD with depository evidence, that the loan had been repaid before HUD was even notified of the diversion. Notwithstanding the previously undisclosed diversion, the area office indicates that the rent increase and other financial relief granted in June were justified based on the troubled condition of the project. Hence, there was no reason to revoke these actions on the basis of the diversion, especially since the loan had been repaid.

### 510 WEST BELMONT

Senator PROXMIRE. Another project mentioned by FHA Tenants United is at 510 West Belmont. According to their material, your Inspector General found that $35,032 in project funds in excess of the available surplus cash was distributed to the general partners. The partners agreed to put a portion of this improper distribution in escrow pending a HUD decision on a rent increase. Why weren't the partners required to immediately repay the total amount of this improper dividend regardless of HUD's decision on the rent increase?

Mr. SIMONS. Again, I will have to answer that for the record.

[The information follows:]

In discussions between the owners, their attorney, their accountant, and Department officials it was determined that some of the distributions and expenses were not, in fact, improper as has been previously reported. Although the partners did attempt to tie the escrow deposit of the remaining portion to HUD's decision on a 1978 rent increase, the Department did not approve the 1978 rent increase and the owners were later required to withdraw the money from escrow and apply it to the mortgage delinquency.

### MAINTAINING PROJECTS AS LOW- AND MODERATE-INCOME HOUSING

Senator PROXMIRE. Apparently the owners of 510 West Belmont were also permitted to use project income to pay the fees of an attorney who assisted the owners in seeking a rent increase. Is this standard HUD operating procedure?

I am not asking for a response to the particulars in that specific case.

Mr. SIMONS. Let me make a comment on that case. There is an interesting thing we are following up on, and we will make a specific response. The interesting thing in this case is that Belmont Towers—I think it is the project—is in a very desirable location in which the value of the property is increasing. This was a project designed to serve low- and moderate-income people. The owners had no right to prepay the mortgage but could have outbid us at a foreclosure sale. In this situation, we wanted to retain this project as a low-income project. The negotiations which took place between the owner and the Department were done with the purpose of retaining it for low-income people. What the actual details of those negotiations were, we are finding out. We will be happy to make them known to you. I assume the Department got what they considered the best deal they could to fulfill the purposes which you and I stated we want so often, to continue to maintain these properties for low- and moderate-income people.

Now, there is a perfect example——

Senator PROXMIRE. In that particular case, though, this wasn't done, was it?

Mr. SIMONS. Yes, it was. I think a flexible subsidy was given on that particular case.

Senator PROXMIRE. That particular project at 510 West Belmont apparently received a flexible subsidy of $898,000. We have been told that the owners put up only $20,000.

Mr. SIMONS. That is correct.

Senator PROXMIRE. Doesn't your flexible subsidy manual require the owners to put up one-third to one-half of the amount of the grant?

Mr. SIMONS. If I am not mistaken, this is an unusual situation. The original concept of the flexible subsidy assumed troubled projects that had no higher market value. Here was a case in which it had a higher market value. We would have lost this project unless we worked it out this way.

Senator PROXMIRE. Let me again ask my question about legal fees, which I didn't get a response to. I pointed out that the owners of 510 West Belmont were also permitted to use project income to pay the fees of an attorney who assisted the owners in seeking a rent increase. I wanted to know if that was standard operating procedure, not discuss the details of that particular case. Under ordinary circumstances do you permit project income to be used to pay the fees of an attorney who helps the owners to get a rent increase?

Mr. SIMONS. Normally that is not permitted. Reasonable legal fees are permitted for the annual operation of the project. It is interesting, in one of the areas we did not discuss generally, the matter of trying to control expenses in dealing with an income stream of about $400 million per month and being sure all that money is expended properly in the proper support of those projects, we have a tremendous management problem. We have responded to it in the fashion of seeking modern computing methods in order to do it. One of those is the creation of what we call the OLM's system which will give a profile of what reasonable operating costs for each category should be within the area of those projects. So if there are deviations from those they would be immediately flagged and brought to the loan servicer's attention.

### HIL'CREST APARTMENTS

Senator PROXMIRE. A third project discussed by FHA Tenants United is Hil'crest Apartments. We have been told that an owner-manager and his family have pocketed more than $65,000 in improper salaries and fees. HUD excused the entire debt by allowing a retroactive increase in the management fee and accepting the contention that $35,228 in excess of the management fee was attributable to the cost of lease coordinators. Is it normal to allow a retroactive increase in management fees?

Mr. SIMONS. Not normally; absolutely not a normal practice.

Senator PROXMIRE. But it is done in exceptional——

Mr. SIMONS. I gather it was done in this case. Again, as I said in my statement before, these are very complex cases. Every one of them represents a troubled project. Until we have all the facts concerning the situation with respect to this case, it becomes difficult to give an answer with respect to the specific item you are requesting

Senator PROXMIRE. May I ask what a lease coordinator is and why this activity would cost $35,000?

Mr. SIMONS. I don't know what a lease coordinator is. I will be very happy to supply the answers on this case for the record.

Senator PROXMIRE. If you don't know, who would? In any event, $35,000 is a lot of money to pay anybody, no matter what his title is, especially when the top people in HUD don't know what the title means. Let me ask you this, How did you verify the validity of the lease coordination charge?

Mr. SIMONS. I will be glad to supply the answer for that in the record.

[The information follows:]

### LEASE COORDINATION CHARGE

A careful review of the files on this project suggests the situation here is complicated and has led to some misunderstanding. The original management fee at this project was 5 percent and included all project-based personnel. In 1972, HUD approved an increase in management fee to 6 percent which did not include project-based personnel. There is no resident manager at Hil'crest Apartments. However, a leasing coordinator acts as a leasing agent and in a supervisory capacity over project affairs. The salary of $35,278 was paid to the leasing coordinator for the years 1972 through 1975, and was not included in the 6-percent management fee.

In a 1976 review of the annual financial statement, the area office questioned both the fee increase and the additional charge for a leasing coordinator without recognizing the 1972 approval. In addition, they noted illegal disbursement for a 2-year period and a further overdraw due to a miscalculation of even the 6-percent fee—a total alleged diversion of $65,000.

In response to the area office request for explanation, the owner/manager pointed out the HUD oversight of the management fee change. The owner made a capital investment to cure the illegal disbursement and, in addition, no further management fees were taken until the diversions were corrected.

In 1979, FHA Tenants United requested the Regional Inspector General for Audit (RIGA) perform an audit on Hil'crest Apartments because of the alleged $65,000 diversion. RIGA reported that the diversions had been corrected in response to the 1976 request by the area office. However, $2,000 of the original illegal disbursement was still outstanding and since 1976 the owner/manager had again miscalculated the management fee. On the basis of the 1979 audit there was a diversion of $6,800. This situation has since been corrected and the area office is closely monitoring this project's financial affairs.

### RENT INCREASE DOCUMENTATION

Senator PROXMIRE. Apparently the Inspector General's report on Hil'Crest Heights indicated that a rent increase request was justified because it was based on a certified audit for calendar year 1978. According to FHA Tenants United the project audits for the years 1976–78 were not certified due to the fact that the owners' CPA's were unable to express an opinion. This is a serious mistake because a rent increase based on an uncertified audit violates HUD regulations. How could the Department have failed to note that the 1978 audit was not certified?

Mr. SIMONS. Again, I will supply that one for the record. If the facts are correct, the Department may have acted incorrectly in that.

[The information follows:]

This is a complicated issue, because of the indefinite meaning of the word "certified." The accounting profession is increasingly avoiding the use of this term. If a certified or independent public accountant reviews a financial statement and reaches some kind of determination, it can be considered certified, even if the determination is that he or she expresses a reservation or qualifies the opinion for some reason, which is then noted.

Recognizing the ambiguity of the term, HUD regulations and handbooks do not use the word "certified" in their requirements for the justification of rent increases. Regulations found at 24 CFR, chapter 401.3, paragraph 2 require submission by the mortgagor of a statement of profit and loss audited by an independent public accountant and covering the most recently ended accounting year. The statements in question were in compliance with these requirements and, therefore, did not violate HUD regulations.

### STONY ISLAND TERRACE

Senator PROXMIRE. The material submitted by FHA Tenants United indicates that the owners of Stony Island Terrace Apartments have placed project funds in escrow with their release conditional on further deferments of mortgage payments and payments to the reserve for replacements fund. Is this allowable under the regulatory agreement and is it a common practice?

Mr. SIMONS. I would not say it is a common practice.

Senator PROXMIRE. Do you know if it is allowable?

Mr. SIMONS. Again, it is a situation we are dealing with, a very complex financial situation, and the Department does use its judgment and discretion to come to the conclusion of making these projects financially viable and keeping the rents at fair rents and trying not to harm the tenants. Generally, this is not an allowable situation. It is not an allowable practice.

Senator PROXMIRE. FHA Tenants United indicated that legal fees are often used as a partial justification for rent increases. Apparently there is a wide variation in these fees. For example, in one project they were $59,261 in 1972; in a second project they amounted to $20,000 in 1977; and in yet another project the legal fees were only $500 in 1977. What standards do you use in determining the amount of legal fees that will be permitted?

Mr. SIMONS. There are legal fees permissible for the operation of a project which will be normal for these projects. What we are trying to do is standardize these, putting together the data from all the projects within an area. Legal fees will vary from area to area. As we get criteria for them, we will then be able to flag the differences.

Senator PROXMIRE. You have no rule of thumb?

Mr. SIMONS. There is no rule of thumb. Each loan servicer is supposed to deal with this in a judgmental way. What we are trying to do is create a system whereby we can be sure they are being dealt with through a definite criteria. That would be our OLM's system.

### RHODE ISLAND PLAZA

Senator PROXMIRE. The committee's investigations staff found that many projects with large and long-standing delinquencies were not under workout agreements. For example, the Rhode Island Plaza project, located in Washington, D.C., has been assigned to HUD for over 25 years with apparently no hope of reversing the financial situation, and yet HUD has not foreclosed on the project or entered into a workout agreement. The project is about $1 million delinquent on the mortgage.

Why has this project remained delinquent for so long without a workout agreement or the initiation of foreclosure proceedings?

### MANAGEMENT GOAL FOR PROJECTS WITH SECRETARY-HELD MORTGAGES

Mr. SIMONS. I will try to find the case specifically, but let me just say this. That project, as I understand it, is current through interest, with the interest payments paid. The whole question of workouts is one that seriously concerns the Department. As you know, we have created an executive management review goal of placing 90 percent of our projects under a plan. We have moved rapidly toward this goal. I think we have now reached about 78 percent of them being under a plan. We have shown tremendous improvement from about 62 percent in May of 1978 to about 78 percent at the end of 1979.

Senator PROXMIRE. Why not make your goal 100 percent?

Mr. SIMONS. It is almost impossible to make it 100 percent because that would be a false situation. There are always projects, a certain number, not under plan, which are being worked on. That is the typical situation that happens and makes 100 percent a false goal. Actually, 90 percent is what we consider 100 percent of the projects that can be dealt with in a given time frame. When a workout agreement expires, there is a time frame needed to deal with those. When there is a situation of a current project going into default, there is a time frame needed——

Senator PROXMIRE. Twenty-five years is a pretty long time frame. According to the investigations staff report——

Mr. SIMONS. Let me point one thing out. My information is that most of the time during the 25 years, that project was current.

Senator PROXMIRE. According to the investigations staff report, this project also involves some questionable transactions. Lustine Realty, the management agent for the owners, Schlossberg & Schneider, forwards 4 percent of its 8-percent management fee to the project owner's firm, allegedly to cover the cost of accounting and engineering services performed by employees of the owners.

In addition, the project owner's decorating company, Schlossberg & Schneider Co., has received an average of $4,325 per month from the project funds.

What was your basis for awarding the management agent an 8-percent fee, when 6 percent is customary?

Mr. SIMONS. That is all under an audit right now. The Inspector General is in there auditing that and the whole question is being looked at right now.

Senator PROXMIRE. Is forwarding half of the management fee to the owner appropriate in any situation, since the management agents are hired by the owners?

Mr. SIMONS. It is not appropriate unless there is work being done by that owner within the management area. There will be an identity of interest there and that will have to be examined on a much closer basis.

## PUMPKIN HILL

Senator PROXMIRE. According to the investigations staff, Pumpkin Hill in Laurel, Md., is another HUD-held project at which less than arms-length transactions have been allowed. HUD foreclosed on three of the four apartment complexes in this project during March of 1979, but still holds the mortgage on the fourth, Birchwood Gardens. The projects were owned by four partnerships, with Ralph D. Rocks as the managing partner in each partnership.

I understand that Rocks owns, in whole or part, Allen & Rocks, Inc., which manages the property, and Rock Engineering which provides maintenance services.

What is the Department's justification for allowing project owners to sell services to their own projects?

Mr. SIMONS. It is permissible under our regulations.

Senator PROXMIRE. What is your justification for it?

Mr. SIMONS. The justification is that there is nothing that should be an absolute prohibition without reason. If that owner is qualified to sell the services and the charges for those services are proper and the services being delivered are proper, it is justified.

Senator PROXMIRE. How do you guard against a conflict of interest under these circumstances?

Mr. SIMONS. Pardon?

Senator PROXMIRE. How do you protect yourself against a conflict of interest?

Mr. SIMONS. The services and charges are examined to determine if the charges are reasonable.

Senator PROXMIRE. How do you determine whether the services are competitively priced?

Mr. SIMONS. We try to determine what would be the price for those services generally in that area.

Senator PROXMIRE. I understand from a recent article that appeared in the Washington Post that HUD now plans to demolish part of Pumpkin Hill and rehabilitate the remainder. What impact will the demolition of these apartments have on the availability of housing for poor and moderate-income tenants in Prince Georges County?

Mr. SIMONS. The Department is in negotiations with Prince Georges County. Part of the negotiations concern Pumpkin Hill and its rehabilitation and bringing back Pumpkin Hill as a viable resource for low-income housing. It also deals with the inherent problems of low-income housing in Prince Georges County generally. I can assure you that whatever the results are of those negotiations with Prince Georges County, the opportunity for housing for low-income people will not be diminished, but enhanced.

We hope not only to accomplish that, but also to accomplish a proper environment for all of these projects which are in trouble in Prince Georges County.

### NEED FOR LEGISLATIVE RELIEF REGARDING FORECLOSURE

Senator PROXMIRE. The GAO report indicates that HUD doesn't believe the foreclosure process can be significantly improved unless various legislative remedies are developed and enacted by Congress.

These remedies, as stated in the report, include the elimination of certain favorable tax advantages for mortgagors; the exemption of HUD from Federal bankruptcy laws; and the enactment of a uniform Federal foreclosure law applicable to HUD projects. Can you tell us what actions, if any, HUD has taken to develop these legislative remedies?

Mr. SIMONS. We will be recommending some legislation, I think, for this session, dealing with legislative aspects of foreclosure. We will be dealing with that, and trying to get an amendment this session to exempt HUD from the adverse consequences of the bankruptcy code.

We are also looking into other legislative initiatives, mainly because we would like to be able to have the right to get into possession of a project prior to the institution of foreclosure, which we find difficult to accomplish in many cases.

With respect to the tax laws, that is something within the prerogative of IRS. I happened to hear some of your questions of the GAO people here. I think our understanding of the situation is where there is recapture of excess depreciation or accrued unpaid interest, it is something which is entirely IRS's area to deal with.

Senator PROXMIRE. You are the Government's expert on housing.

Mr. SIMONS. Thank you.

Senator PROXMIRE. You certainly are, and IRS is not. I think they would acknowledge that fact. It seems to me any initiative to improve housing, to improve your operation, would have to come from you, even though I would recognize, of course, that Treasury and IRS has to pass on it.

Mr. SIMONS. I have had discussions with Commissioner Kurtz. We realize that IRS' policies and dealings affect housing policies very seriously.

We are working closely together. We are continuing to cooperate with one another in areas which we have discussed.

Senator PROXMIRE. I have here a memorandum from Mr. Robert Kalish who works for your Office of Multifamily Financing and Preservation, to an Assistant General Counsel suggesting that HUD might be able to waive their right to accrued unpaid interest on HUD-held mortgages as a means of preventing owners of properties in the HUD inventory from taking a deduction of this unpaid interest on their income tax returns.

The memo states:

> The accrued unpaid interest on principal is large and, with few exceptions, will never be paid to HUD.

The memo goes on to state:

> Unpaid interest is not only a windfall, but actually a strong monetary incentive for owners to string out the foreclosure process as long as possible.

Wouldn't it be better to change the tax laws to eliminate this loophole than it would be to wipe the interest obligations of these owners to the Federal Government off the books?

It's a tax loophole, obviously, that, as Mr. Kalish points out, contains an antisocial incentive.

Mr. SIMONS. I think Mr. Kalish's memo doesn't point it out so much as a tax loophole.

Senator PROXMIRE. That is my observation.

Mr. SIMONS. What his memo points out is that what happens when an owner accrues interest and eventually there is a foreclosure, the owner suffers recapture for the accrual of the unpaid interest but the Department gets no credit.

Senator PROXMIRE. You say the owner suffers recapture. We made the point, on the basis of the fragmentary evidence we have, one document, that in about 85 percent of the cases, the owner never does pay up.

Mr. SIMONS. That, of course, is enforcement by IRS.

I am not in a position to render an opinion as to whether they do or not. I will say this: There is close coordination going on between the Department and IRS to make available to them all the information they need for their enforcement activities. I think the issue is whether or not their enforcement activities can take care of this, not if we decide to waive interest, which is an issue we discussed 3 months ago. If we decide to waive interest, the Government will have a loss of income.

Now that provides a little tension between the desire to keep the FHA fund as a financially viable one, vis-a-vis forgiving interest because we want to prevent owners from getting so-called tax windfalls. In my opinion, if there is a way of not giving the tax windfall to the owner, then there is no need for us to waive that interest.

Senator PROXMIRE. What you are saying, then, you have to enforce the law.

Mr. SIMONS. That's right.

Senator PROXMIRE. Requiring that interest payments be deducted on a cash basis as an exception to the tax law would be very simple where there is obviously an abuse involving a HUD-held mortgage.

### TAX LOSSES DURING FORECLOSURE

Mr. SIMONS. There is no question an exception can be made for a HUD-held mortgage. I think what is more important in dealing with the tax aspects of foreclosure is overcoming the problem which has given us the reluctance to foreclose.

Our experience has been that when we institute foreclosure, many of these projects take an extraordinary length of time to foreclose, which has been pointed out by the GAO and your committee. During this period, we suffer a great loss, not only to the physical plant, but to the tenants and the project's habitability.

If the law—and this is something we are looking at seriously, and I am sure you will be looking at seriously—if the law can give us the ability to institute foreclosure and get possession immediately, then we ought to shorten the time frames for foreclosure, and then we are in a position to use foreclosure more aggressively as a tool in the management of these projects.

I do not think it is necessary to go through the IRS situation, because the Department is moving to being an active servicer, to be more aggressive in these areas, and what we need is the tools to be that aggressive servicer.

Senator PROXMIRE. If you forgave these interest payments, what would prevent an owner from bringing the mortgage current by paying the relatively small amount of principal due on the mortgage and thus avoiding foreclosure?

Mr. SIMONS. We could prevent them. I think the foreclosure problem is not the problem. We could forgive the interest payments and I am sure legally protect our right of foreclosure.

Senator PROXMIRE. How long has HUD been aware that accrued interest, even though not paid, can be claimed by the owners as an income tax deduction?

Mr. SIMONS. I have been aware of it ever since I have been in the Department.

Senator PROXMIRE. You are unusually smart. I mean it as a compliment.

Mr. SIMONS. I understand that.

Senator PROXMIRE. Why did GAO have to inform IRS of the accrued interest issue? It wasn't until the GAO auditors brought it to IRS's attention that IRS agreed to include it in their study of the recapture of excessive deductions taken for low-income housing projects.

Are you two agencies not communicating on this issue?

Mr. SIMONS. We are communicating. It is very difficult to make me answer for IRS's mind set and priorities.

Senator PROXMIRE. But you told them about the problem?

Mr. SIMONS. They are aware of it and we are dealing with them on it.

Senator PROXMIRE. GAO apparently had to tell them about this interest problem to get the accrued interest issue included in the study.

Mr. SIMONS. It depends.

Senator PROXMIRE. In the GAO report it is stated that the proposed IRS recapture study is scheduled for completion in late 1981. The GAO report said that the estimate for completing the study is dependent on HUD providing IRS with necessary information for their study— information which was requested in May of 1979. Could you elaborate on the data IRS needs for its study and tell us why the data has not yet been turned over to IRS?

Mr. SIMONS. I don't think that is a fair statement. I do know our data people are cooperating with IRS and making available to them the data they are seeking. I will be happy to provide for the record the exact requests which IRS has made of us. I think the characterization that we are not providing them with the data may be an incorrect characterization.

Senator PROXMIRE. When does HUD expect to provide IRS the information needed for its planned study of the recapture of depreciation and accrued interest deductions which are now available to project owners?

Mr. SIMONS. I will discuss that generally, but I will be happy to get specifics on this for the record.

[The information follows:]

Information relating to projects on which the mortgage was foreclosed or prepaid was submitted to the IRS in November of 1979. A memo will be issued shortly requesting information from the field on profit-motivated and limited dividend mortgagor changes and transfers of physical assets. We expect this information to be available to the IRS in April.

Senator PROXMIRE. Can you describe for me the extent of the discussions HUD had with IRS representatives on the need for legislation in the area of tax benefits for multifamily mortgagors?

Mr. SIMONS. Basically our discussions have not been along the lines of legislation or the need for regulations. The discussions have been along the line of enforcement. I think you will find IRS has moved more actively and has taken positions which cut away the fringes of the tax benefits on some of the issues that are raised by the taxpayers as to what is deductible and what is not in connection with the tax benefit.

### LATE CHARGES

Senator PROXMIRE. GAO has testified that at the time of their review, HUD-held projects which were current were being assessed for making late payments while delinquent projects were not assessed late payment charges.

Why aren't late charges being assessed on delinquent assigned projects?

Mr. SIMONS. First of all, when we get to a workout, we already have a troubled project. When we have a delinquency under a workout, we have a troubled, troubled project. So the addition of late charges is not an incentive, really, under the workout.

Senator PROXMIRE. Why not assess late charges against delinquent assigned projects as an incentive for the owners to make timely payments when the projects are under workout agreements?

Mr. SIMONS. We don't feel that would act as an incentive in those situations.

That is like creating an incentive where the incentive will have no effect whatsoever.

Senator PROXMIRE. Why wouldn't it?

Mr. SIMONS. These are projects in financially troubled periods, and their inability to make those payments is really what the whole problem was and why it got to the workout in the first place. When we go to the workout we use our best judgment to insure the owner can make those payments. The reason we got there is because that judgment, in the first instance, did not work out.

Senator PROXMIRE. You said the Rhode Island Plaza project was delinquent for 25 years and made payments on their principal.

Mr. SIMONS. Rhode Island was current during much of the 25 years on interest payments.

Senator PROXMIRE. Why wouldn't a penalty have given them an incentive to make timely payments?

Mr. SIMONS. They usually try to pay anything they can to keep these projects as close to the workout agreements as possible.

By adding the late charges, you are compounding the indebtedness and making the eventual workout harder to take place.

### SO-CALLED NET CASH WORKOUT AGREEMENTS

Senator PROXMIRE. In that case, there is no workout.

The GAO has indicated that under net cash workout agreements, the mortgagor can pay nothing and be considered current. What is a net cash workout?

Mr. SIMONS. A net cash workout is a workout whereby the cash submitted to the Department for debt service or for money owed to the Department is that money left after the receipts are tallied and the allowable project expenses are deducted from those receipts. The balance is then paid to the Department for the debt service due.

Senator PROXMIRE. Don't net cash workout agreements leave the door open for creative accounting? And why were they created? By creative accounting I mean you can play around with the books and end up not having to pay anything.

Mr. SIMONS. Let me say this: We have created minimum payments on all our new workouts and are no longer approving net cash workouts. From the standpoint of solving problems the servicer faces when dealing with a project that is in deep trouble, the net cash workout, or the concept of it, is not so astounding. Those are usually monitored very closely and, as I said, the systems as to proper allowable expenses which we are putting in place will give us better control over those.

These are usually projects that need time to work themselves back into some shape so we can deal with them.

### FIELD STAFF ATTITUDES

Senator PROXMIRE. In the final report of its multifamily property utilization task force, HUD identified as one of its major problems the fact that its loan management field staff had little experience in dealing with subsidized housing, that staff accustomed to assisting mortgage lenders and developers had simply been unable to shift its focus to the problems of tenants, and that field office staff is often insensitive and unresponsive to tenant complaints.

What steps is the agency taking to address this very serious problem of attitude on the part of field staff?

I might point out that tenants—and you know this better than I do, you have a marvelous record of sympathy for and assistance to tenants—tenants with modest incomes are relatively inarticulate and are easily pushed around. They aren't really represented well. Often they don't vote. They are often minorities who suffer discrimination in all kinds of ways. It seems to me HUD ought to be sensitive to that.

In fact, we do have a vigorous tenants organization represented here today that ought to be encouraged. But the field office staff, on the basis of the testimony we have, does seem insensitive, or at least not helpful and sometimes actually seems to be hostile to the tenants.

Mr. SIMONS. First of all, I have a meeting with them this afternoon, which I look forward to. When we talk about implementing changes in policies, and as we pointed out in that 1977 report, these are going to have to be dramatic changes in policy that take place, it doesn't just happen. We have the responsibility to make it happen and we do this in a number of ways. To have a policy just enunciated at the central office and not implemented at the field office is not to have any policy at all, but to take an organization which has been working in a certain way for many, many years, and change that dramatically is difficult because we are implementing many new policies——

I mentioned one or two today such as the tenant comment on the rent increases, the whole tenant participation regulation, the new 290 regs which mandate tenant participation in the disposition of our projects—many things such as that are totally new policies.

### THE POLICYMAKING PROCESS

Let me describe to you what the process is, because I, as much as anyone in the room, wish I could enunciate a policy and then say it is done.

I know it is not easy. The first step is to create those policies, develop the regulations, the handbooks, the notices, and put it onto paper.

The second step then deals with the systems and the procedures necessary to support those policies, which are usually done at the same time. They can be very complicated and it is a very difficult task, but one which we have coordinated very well with Secretary Medina and his people.

The third step, then, is the dissemination of these materials, the sending out of the written materials, the training sessions, meeting with housing directors, area office managers, memos to the field, and then the actual implementation process starts.

This year we will be doing extensive training in this area. We haven't done it before because it has taken us the last year to develop these policies and handbooks in order to start the implementation.

The measures of success are then put into place to give us, the central office, and area office managers and regional administrators, the ability to monitor these projects and policies.

What will be most important, Mr. Chairman, will be as we put these policies into place and complete our training, to be able to have the proper staff resources. When this Department comes before the Congress for those staff resources which we feel are minimally necessary to accomplish the purposes, we are going to need them. There have not been any requests that have been denied to date.

The reason is we want to be sure the staff is properly trained and policy and procedures are properly supported by the systems that are developed.

Senator PROXMIRE. Mr. Secretary, I said at the beginning of your testimony that I was sensitive to the fact you were having lunch at the Vice President's Mansion. So in view of the fact you are looking forward to grits with Fritz I am going to ask you whether you would like to make a summary of what we have been unable to cover in this question period.

### COMMITMENT TO CONTINUED IMPROVEMENT

Mr. SIMONS. I would just like to say a few things, Mr. Chairman.

First of all, I thank you for the courtesy which you have extended to me today. We have been in the process of extensive hearings on this subject, the subject of troubled projects. We had extensive GAO reports, Senate Appropriations Committee reports, all of which shows our attention has been properly focused on what is a very serious area. We have no disagreement. I think all of the reports point out that there is no disagreement that this is a serious area meriting tremendous attention.

What is more interesting to me is that we have made known to them the policies and what we are planning to do, and what we have done. These reports do not suggest any alternatives to what we are doing. They say we are on the right track.

I think, as you pointed out in your opening statement, the issue is whether we can keep putting this together and keep moving it forward. I assure you of my personal commitment to this. We will be very happy to keep you informed and the committee informed on the steps and the progress made in dealing with this problem.

I think that is essential, and I think these hearings today have helped focus on what is really the essential area.

I would hope that as we do this, and as the need for resources for the Department increases in this area, because it will, that we will have the cooperation of this committee and the Congress as a whole.

I would like to thank you for this opportunity and assure you of our continued cooperation in this area and all areas as they affect housing.

It has been my pleasure to work with you for 3 years in this committee, and I look forward to a fruitful and productive year.

Thank you very much.

Senator PROXMIRE. Thank you very much, Mr. Simons. I appreciate that.

I do know you are taking steps to deal with your very serious multifamily problems, as outlined in your statement.

As I indicated, we will expect reports in writing every other month on the progress you are making so we can follow that progress and we are looking forward to your testimony on May 1, when you will come before us with your 1981 budget request. We will be watching the multifamily problem very closely.

As you know, I wear another hat as chairman of the Banking, Housing, and Urban Affairs Committee. We will be looking at your authorization there. We have all sorts of thumbs.

Mr. SIMONS. I look forward to it.

## SUBMITTED QUESTIONS

Senator **Proxmire.** We also have a number of questions for the record, as does Senator Mathias.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

## Questions Submitted by Senator Mathias *

### ACTIONS UNDERTAKEN BY HUD TO RESOLVE PROBLEMS

In December you prepared a 30 page paper for the record entitled, "HUD's Efforts to Improve the Management of its Multi-family Housing Programs." Most of the questions that I will be asking will relate to statements HUD has made in this paper. Before proceeding, however, I would like to compliment the Department on its preparation of this document. In my opinion, it clearly identifies the major problems faced by HUD in the management of its housing programs and does so in a constructive manner. This paper is as critical of current HUD practices as is any document that we have or will be including in the record. It is refreshing to see a government agency recognize its shortcomings and develop a plan to correct them.

In June 1978, the final report of the HUD's Multi-family Property Utilization Task Force was issued. Three general conclusions emerged from that study:

1. Project incomes were generally found to be inadequate
2. Inadequate on-sight project management
3. Inadequate HUD management and oversight.

In support of these basic findings, you note that HUD:

- o Had an inadequate number of professionals staffing the project
- o Employees had inadequate skills to manage the program
- o Staff had inadequate secretarial and clerical support.

On the basis of this analysis, it is obvious that hiring, training and upgrading of the staff is required.

What actions has HUD undertaken to resolve these problems?

Answer No. 1

These are problems which will only be resolved through long-term incremental efforts. Unlike policy or procedural changes, they cannot be accomplished through a relatively straight forward policy analysis and development process.

As a first step in this longer process the Department, with the Offices of Housing and Administration working closely together, has developed new work measurement standards for most loan management functions to reflect accurately the workload of our loan management staff in the field. In addition, new positions in the loan management area were allocated in the field. Increased emphasis on training, reflected in this year's training

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* Note: The Mathias' parts were copied
without correction from his submission.

schedule and the development of the modular financial analysis training course, will begin the long-term process of upgrading the staff to the skills level that will enable them to make full use of the more sophisticated tools which we are providing and, consequently, be more effective at the loan servicing function. In addition, with the assistance of a nationally respected management consultant, we are reviewing the classification and qualification standards which determine who we can hire and at what grade. Recommendations for changes necessary to permit the Department to secure the skills it needs in this area will be made. Also, a standardized office structure will be developed that will provide positions encompassing all the skills required in a field office such as maintenance engineer, financial analyst and occupancy specialist.

## INADEQUACIES IN MONITORING AND MANAGEMENT SYSTEMS

Your report also found that the HUD staff was hampered in performing its function due to the lack of adequate monitoring and management information systems.

Could you please expand on the inadequacies currently existing in the monitoring and managment systems and the current activities underway at HUD to resolve these problems?

Answer No. 2

I refer you to the 30-page paper, the June 1978 Final Report of the Multifamily Property Utilization Task Force and our testimony, which is responsive to this precise question.

Could you please also indicate the status of each of these systems during FY 80 and FY 81.

Also indicate the amount of resources to be devoted to each of these systems during FY 80 and FY 81.

Answer No. 3

The Department is submitting for the record a separate timetable for the accomplishment of the various improvements in the management of our multifamily project inventory. It indicates the steps planned to implement the changes and the schedule for implementation. We will be reporting on a bimonthly basis on our progress in meeting the timetable and bring to the Committee's attention any delays we may encounter.

Our Headquarters' resources are not allocated in such a fashion that we could readily provide a meaningful description of the "amount of resources to be devoted" to each of these items during a fiscal year. We will attempt to allocate our resources in such a fashion as to implement these changes according to the schedule provided. Once they are in place, they will be a part of the overall management and administration of our programs.

## OLMS ENHANCEMENT

It is my understanding that the Office of Loan Management Computer System (OLMCS) will be enhanced to include expense data that will permit the generation of an operating budget and rental schedule for the next year on each HUD-owned project.

When will this enhancement be completed?

Answer No. 4

The planning phase for the OLMS enhancement is scheduled for this spring followed by a design phase lasting through September 1980. The programming stage and target date for the system's full enhancement will not be set until the planning phase is completed.

On page 26 of your report, you note that the Department's goal is to obtain an accounting system that "provides for automatic tracking of payments to under workout agreements, monthly delinquency reports, annual escrow analyses and annual account systems." When will such a system be available?

Answer No. 5

The schedule for implementation of the specific accounting changes responsive to our HUD-held inventory management problems is included in the overall timetable referred to above. Generally, all the necessary changes will be in place this year.

## CLEAR UNDERSTANDING OF FUNCTION LACKING

Your report also found that the management and environment in which HUD's Housing staff function was deficient in several respects. One of the basic issues uncovered was that the Housing Management staff did not have a clear understanding of their function, that is, the goals and objectives of the Department. Lacking such an understanding the reward and accountability structure at HUD was in support of efforts to improve the management of the housing program.

What has been done to correct this situation?

Answer No. 6

A major emphasis of this Administration in the past three years has been the importance of the Housing Management function. Through many meetings with Headquarters staff in all program offices, Regional Administrators, Area

Office Managers, Housing Directors and the public, we have reiterated this emphasis. It is now reflected in our Operating Plan Goals, which include objectives relating to limited and comprehensive management reviews as well as the percent of HUD-held inventory which should be under an approved plan for the resolution of project problems. Our training sessions serve to further emphasize this focus of our program efforts.

And, in fact, these hearings have underscored our previous efforts in this area, demonstrating that our concerns are shared by the Congress.

In addition to identifying the above noted problems, the report describes a series of changes that have taken place at HUD since the Task Force Report was completed. I would like you to expand on some of the statements in that section of your report and present specific examples of how these changes have positively affected the management of your housing program.

For instance, you stated that the Department has made a decision to "aggressively service HUD's multi-family project, replacing passive servicing based on reaction crises with preventive servicing designed to anticipate and prevent trouble."

In terms of site visits, audits, etc., how will this policy decision be reflected in the workload of your staff?

Answer No. 7

All of the management changes, such as the requirement for a detailed troubled project analysis as part of the flexible subsidy program, are reflected in our work measurements standards. These standards prescribe typical amounts of time required by each discrete function and determine our staff and workload allocations, as well as provide the basis for our staff requests. There is no question that our workload will increase as our overall inventory grows but increased sophistication, through training as well as enhanced technology, should help offset some of that necessary increase.

## REPAIR FUNDS COMMITTED

Another decision that you state that HUD has made is to, "immediately repair properties owned by the Department ... to insure that tenants in these projects are providing good quality housing."

Could you please provide a history of the repair funds committed on an average annual per unit basis by HUD for the two years proceeding the new policy? Please provide the same information for the period since the formulation of the new policy.

Answer No. 8

One of the deficiencies we have noted in the management of our HUD-owned inventory is that we do not have the kind of expenditure accountability which would enable us to tally repair funds on a per unit basis. Accounts at Headquarters were maintained on a 'net' income basis, meaning that repairs which could be paid out of normal project income might never be tracked or noted specifically. Budgeting and accounting changes we are developing will remedy this situation.

Prior to the planned repair policy, we made only emergency repairs so we did not actually commit repair funds in advance from the insurance fund to HUD-owned projects.

In FY 1979, the planned repair program consisted of $30 million dollars specifically set aside in the FHA insurance fund for project repairs. Of that set aside, $25.2 million was actually committed for the planned repair of projects containing 16,413 units, or roughly $1,530 per unit.

## STATUS OF WORKOUT AGREEMENT

One of HUD's objectives has been to establish a work out agreement for each HUD-held project. The Department has specified that its goal for FY 79 was to have 90% of these projects under such agreements.

We have just heard from GAO that a large number of the projects that they reviewed were not in such agreement.

What is HUD doing to expedite the development of such work out agreement and what goals have been set for FY 80?

Answer No. 9

We have set the FY 80 goal at having 90% of our HUD-held inventory under an approved plan, which means current in payments under the original mortgage, in foreclosure or under a formal workout agreement. To us, this goal actually represents 100% of the projects which can reasonably be expected to be under plan at any given time, once allowances are made for turnover, expiring plans and the time it takes to place projects under a plan initially.

In addition, we are actively developing a workout workbook for field use which, when distributed, should make the process of developing workout agreements more uniform and enable us to attain our goals more readily. It will serve also to improve the quality of our analysis and the subsequent workout agreements.

What specific steps are being taken by HUD to improve the assistance to, and the monitoring of, troubled projects?

Answer No. 10

Our entire efforts in this area, as described in the 30-page paper, are aimed towards improving the monitoring of troubled projects, improving program management and providing assistance to these projects.

TENANT INPUT REGULATIONS

Please describe the intent of the tenant input regulations (Section 402 and Part 290) and the importance that HUD places on such tenant participation.

Answer No. 11

These regulations are intended to encourage tenant comment on actions having a major impact on tenants. An active, concerned, aware, tenant body can be a valuable asset for solving many of the problems of troubled projects. We see this as a very important element of our overall strategy.

You noted in your report that HUD is considering the submission of a legislative proposal establishing a uniform foreclosure process for HUD subsidized projects. According to your analysis, this expedited procedure could make foreclosure a more effective tool in dealing with uncooperative owners.

What is the status of this proposal?

Answer No. 12

We are drafting such a proposal and hope that Congress will consider it during this legislative session.

At present, owners who refuse to make mortgage payments continued to receive income tax deductions from accrual of unpaid interest and service charges. It is my understanding that the Department intends to explore ways of reducing such tax benefits.

Could you please describe your efforts in this area?

Answer No. 13

We are examining options for denying this benefit to owners of troubled projects. No specific recommendations have been made yet.

MANAGEMENT SELECTION PROCESS

One of the Task Force's major findings was that projects deteriorate rapidly once HUD assumes ownership. In response to this finding, you have initiated a two step management selection process.

How do you expect this process to help and what else is needed to prevent such deterioration?

Answer No. 14

The two-step process responds to the larger need for improved project management. Improved management will clearly assist in preventing deterioration resulting from unsatisfactory project management. The process should enable us to better select competent management. The major initiatives in this area are to improve HUD-owned project servicing and monitoring, get possession or control of projects when mortgagors appear likely to permit deterioration and to acquire title more quickly in those same situations.

In an effort to reduce claims against the Mortgage Insurance Fund, you intend to implement a "partial payment of claims program." This procedure would allow the Secretary to file a claim for only part of the mortgage balance and recast the remainder over the term of the mortgage. The mortgagee would then hold only that portion of the mortgage on which the debt services can be supported by project income.

How effective do you believe that this procedure will be in reducing cost to the insurance fund and how will HUD assure the legitimacy of the claim and the projected project incomes and expenses?

Answer No. 15

This procedure could prove beneficial. However, its effectiveness will depend upon a mortgagee's willingness to accept a partial payment of a claim under the mortgage insurance contract. To the extent that we pay only part of a claim, and that enables a project to stabilize financially, the cost to the insurance fund will be reduced by the amount not paid. The legitimacy of the claim will be assured as in the past by a determination that there was a valid default. In addition, mortgagors who would benefit from lower mortgage payments will still have the same total principal obligation. Feasibility will be determined on a case-by-case basis using our troubled projects' income and expense analysis procedures, supplemented by OLMS and a detailed budgeting process.

## QUESTIONS SUBMITTED BY SENATOR PROXMIRE

North Canal Apartments and Princeton Village - Lowell, Mass.

Q: The Committee's Investigations staff found that the brother of the resident manager of Northern Canal Apartments and Princeton Village in Lowell, Massachusetts was hired to paint apartments on a contract basis. The resident manager was responsible for deciding which units should be painted and supplied an average of six gallons of paint per apartment per year. Although his brother received payments totaling almost $60,000 in one 13-month period, a visit to the project by the Investigations staff revealed cobwebs in many rooms that were supposed to have been newly painted. In several apartments, while some painting has been done, there were holes in walls and other damage that should have been repaired prior to painting.

1. It would appear that in this case the tenants as well as the taxpayer may have been short-changed. Has a subsequent investigation been conducted by HUD concerning this matter and, if so, with what result?
2. Is the resident manager's brother still painting these apartments?
3. What controls does HUD have to detect and prevent situations such as this?

A: The problem with the painting job at these projects is not as great as first reported. At North Canal there were two rooms found with cobwebs, and there was only one apartment with holes in the walls. This project suffers from many physical defects dating back to the time of construction and suffers from vandalism as well. It also has a high turnover rate. These circumstances affected the painting job.

The loan servicer assigned to these projects discovered the identity-of-interest between the resident manager and painting contractor during routine servicing. Subsequent investigation showed that per unit costs on painting were comparable to other area painting costs and had been the same for the last five years, $100-125 per unit. The painter had been employed at these projects prior to his brother becoming resident manager. However, the concern of the loan servicer was not just the painting job mentioned in your question. Rather, the servicer's reviews of the project led to concern about the overall management practices of the managing agent and the attitudes of the owners towards improving project conditions.

The Area Office has been aggressively pursuing remedies to these projects' problems. As an example, when requests to owners to replace management at both projects were not heeded, the Area Office terminated the management contract at both Princeton Village and North Canal. As a result, both the resident manager and his brother will no longer be employed by these projects. Recently, the AO has informed the owner that they must submit a workable plan to reinstate both projects prior to the end of February, or face foreclosure.

In this instance, HUD procedures already in place are being used in dealing with problem projects -- review of monthly accounting reports, review of annual financial statements and comprehensive on-site management reviews.

From the experience with this project it is evident that HUD's servicing procedures can and do work.

Pine Towers - Phoenix

Q1: The Committee's Investigations staff found that the Acting Los Angeles Area Manager waived pertinent regulations pertaining to the sale of Pine Towers, a HUD-owned property in Phoenix, so that it could be "processed without the required competition". After HUD headquarters was advised of this situation, the Acting Area Manager was advised by letter that he lacked such authority, but in the same letter he was permitted to allow the waiver, with little justification.

Doesn't this approach give the appearance of condoning such action on the part of this area manager?

A: Although this property was in the foreclosure process it had still not been acquired when the sale took place. The issue here was the sale of a privately-owned project with a HUD-held mortgage to private individuals for rehabilitation and eventual sale to a PHA. The city of Phoenix strongly endorsed the PHA acquisition of this project, which would provide the first public housing in the eastern portion of Phoenix. The PHA indicated that this project would only cost 57% of what a newly constructed comparable project would cost.

The Acting Area Office Manager was incorrect in waiving competitive bidding. Assistant Secretary Simons admonished him officially, warning him that his action was in violation of HUD procedures. However, the sale was considered to be in the interest of the Department and was permitted to go forward.

Q2: Does HUD have a clear, set procedure for determining how, by whom, and under what conditions regulations may be waived?

A: Yes. Waiver of regulations is undertaken in exceptional circumstances based on a review of the facts and recommendations at issue. Not all regulations are waivable and, of course, statutory provisions cannot be waived. Notice H79-74 addresses requests for exceptions or deviations from Departmental policies, standards or regulations. It states that exceptions and deviations from a HUD regulation "shall be submitted to the appropriate Deputy Assistant Secretary or Office Director and where appropriate the Assistant Secretary, as outlined in Chapter 5, Handbook 1105.1, Rev. 2." In this instance, the transmittal to Handbook 7417.1, Public Housing Development states that no modification or deviation from the Handbook may be made without prior written approval of the Assistant Secretary.

## Bid-splitting

Q: The Committee's Investigations staff report revealed a pattern of bid-splitting in order to avoid a HUD requirement for formal competitive bids on purchases over $2,000 since purchases under $2,000 may be negotiated. Furthermore, the Investigations staff found that the Detroit Area Office had actually encouraged this practice.

Has HUD Headquarters taken any action to determine how widespread the bid-splitting practice may be?

What, if anything, has HUD done to halt this practice of bid-splitting as a means of avoiding the $2,000 rule?

A: It should first be understood that competitive bidding on small contracts typically involves more administrative processing than is justified by the amount in question. This is the basis for allowing small purchase procedures under a certain dollar ceiling. Until recently, that ceiling had not been raised to reflect the impact of inflation and as a consequence items which might have been subject to small purchase procedures in the past were being forced into competitive bidding. Government Procurement regulations have been recently amended to require formal competitive bidding only on purchases over $10,000, thus reflecting the impact of inflation on program operations.

The Department's actions to detect the existence and extensiveness of "bid-splitting" consist of its normal process of routine contracting reviews. As provided for in HUD Handbook 1170.1, Regional Contracting officers in each of HUD's ten regions are assigned the responsibility of determining if current federal procurement regulations and procurement handbooks are being followed. Reviews are generally conducted for each Area Office once per year.

In addition, when appropriate, Headquarters performs intensive reviews of Area Office contracting procedures including on-site reviews of projects where the contracting activity occurs. When violations of HUD handbooks and regulations or other deficiencies are identified, the area office is ordered to cease such practices and make corrective actions.

Such reviews were performed by Headquarters in 1979 in seven area offices. The Headquarters reviews indicated that "split bid procurement" was not a widespread problem throughout the offices surveyed. However, the review of one particular area office, the Detroit Area Office, determined that small purchase procedures were used for repairs and maintenance in cases where formal advertising procedures should have been used.

The Detroit Area Office subsequently indicated that the contracting unit of the Property Disposition Section was unable to service requests for formal competitive bid contracting on a timely basis because of the heavy volume of formal contracting activity. In addition, the contracting unit had not had a permanent chief for about one year.

In a letter to the Area Manager, Assistant Secretary Simons summarized these and other findings of the review and reaffirmed that "compliance with formal advertising requirements must be assured...The present method of using purchase orders is indefensible with respect to economy, efficiency and regulatory requirements." Mr. Simons concluded that "as a guide for improvement, procurement regulations, contract repair specification requirements and general contract terms must be followed."

The Area Office, in response, agreed with the points raised by

Mr. Simons and indicated they had hired three new staff members with extensive experience in contracting including a permanent chief of the Contracting Branch.

Bellcrest Country Club

Q1: The Investigations staff found that in the Bellcrest Country Club Apartments project in Chicago, commercial space used as a restaurant and night club was being rented by the owner for $500 per month without a written lease. The area rented was estimated to be approximately 2000 square feet which meant the space rented for 25¢ per square foot.

Do you think that is a reasonable rent for restaurant and night club space on South Shore Drive in Chicago?

Q2: Has HUD now taken steps to secure a lease for this space?

Q3: Are there regulations concerning the rent to be charged for commercial space in HUD insured projects?

A: The restaurant in this project has been a service to the elderly tenants who are reluctant to venture into the surrounding declining neighborhood. The Belcrest Corporation, Inc. is renting this space and has made an arrangement with an individual to serve the food which is prepared outside the premises.

There are no regulations regarding rent of commercial space in Section 236 projects. Normally, the owner would be expected to rent this space at no less than the amount determined during initial processing. However, the Insured Project Servicing Handbook 4350.1, Chapter 4, Section 3, Rents and Carrying Charges, states that rents for all commercial space must be approved by HUD. Such rates constitute a floor rather than a ceiling. Should there be business reasons which justify a specific reduction in rents below the levels established in initial processing, a statement of facts and circumstances should be filed by the mortgagor with the Department.
In this instance, the Area Office felt that the low rent was justified because it enabled a food service to be offered to the tenants and because no one else would rent this space as a restaurant. The mortgagor was remiss in not requesting a reduction in rent for this

space and the Area Office was remiss in not pursuing this issue. A request to the owner that a formal lease arrangement be established was made by the Area Office in August 1979. There is still no lease for the restaurant. The owner indicated in December that the arrangement with the restaurant operator will be terminated shortly because the restaurant operation is not making any profit. The Area Office plans further action on this case during the comprehensive management review presently underway.

The remaining commercial space is leased to two insurance companies and a dentist. There are signed leases for all three. Current rent on this space is 2 1/2 times the rental rate at initial processing.

Mt. Zion Tower - L.A.

Q1: The Committee's Investigations staff learned that $65,000 in project funds was missing from Mt. Zion Tower, a project supervised by the Los Angeles Area Office. The Chief of Loan Management in L.A. said he had not requested an investigation of this matter by the HUD Inspector General because he thought that the funds would be recovered upon foreclosure.

Why didn't HUD immediately investigate this apparent diversion of project funds?

A: The Area Office discovered this diversion in a review of the financial statement for 1977. This was not an authorized use of project funds and the Area Office made several attempts to recover this money from the nonprofit sponsor. The money had been turned over to the project's attorney to hold during a legal battle with the building's contractor. The HUD LA Office knew where the money was and knew it was still carried as a project asset which would be acquired by HUD through foreclosure.

Q2: Is it common practice for HUD to let a diversion of this magnitude ride until foreclosure?

A: Diversions of project funds must always be pursued but each particular case provides a different set of facts and often different scenarios for recovering funds or taking other remedial action. For instance, it may not make sense to pursue expensive litigation to recover a small amount of money but rather seek to debar the concerned individual or firm. In this case, it was decided that the funds could be most effectively recovered through a civil suit at the time of foreclosure.

Q3: Has this money been recovered as of this date?

A: No. The foreclosure was recommended on this project in June 1979. While California is a nonjudicial state, it was determined that since the parties involved would contest the foreclosure, judicial foreclosure would be the best course of action. This action is currently underway.

Burnham Oaks - Park Forest South

Q1: I understand that the Burnham Oaks Apartments project in Park Forest South, Illinois was $2 million delinquent on March 20, 1979. At that time a workout proposal had remained in the Chicago Area Office for 6 months with no action being taken to either approve or reject it.

Do you think allowing a $2 million delinquent mortgage workout proposal to remain unacted upon for 6 months constitutes adequate loan servicing?

A: To allow any workout proposal to sit for six months without reviewing, analyzing and responding to it is certainly less than the Department is trying to achieve. The Department still faces a substantial backlog of cases, troubled and assigned projects, not under an approved plan for resolving their problems, and as could be expected, many of these are concentrated in the several larger offices such as Chicago. Since establishing the operating goal of 90% of our HUD-held mortgages under plan, we have made significant progress in reducing that backlog and are continuing our emphasis in that area.

Q2: The Committee's Investigations staff reported that the last inspection of the Burnham Oaks project was in 1973.

How often are assigned projects supposed to be inspected?

A: Our existing instructions to the field require that all insured and assigned projects have an annual physical inspection which is conducted by either a maintenance engineer or loan servicer.

In the 1980 Departmental Operating Plan, any project classified as troubled, whether subsidized or unsubsidized, is required to have an annual comprehensive on-site management review as part of the more intensive servicing procedures of troubled projects. A comprehensive review would include a physical inspection and reviews of leasing and occupancy practices, tenant management relations, financial management and general management practices. Non-troubled projects are required to have a more limited management review, annually if subsidized and biennially if not. Completion of on-site management reviews is being monitored through the Department's monthly Executive Management Report (EMR) and Operating Plan (OPLAN) process. The completion of both comprehensive and limited management reviews and physical inspections is to be monitored in the Multifamily Insured and Direct Loan System (MIDLIS) which should be in operation this fiscal year.

Q3: The Burnham Oaks project, according to the resident manager, has suffered from roof leaks and difficulties of keeping the fifth floor apartments warm in winter due to a lack of insulation in the concrete ceilings. I understand that in an attempt to stem the heat loss in these fifth floor apartments the maintenance supervisor had styene foam paneling insulations glued to the ceilings and painted, leaving the insulation exposed. The labeling for this insulation, of which I have a copy, states that the product is combustible, that exposure to flames, sparks or excessive heat should be avoided, and that the insulation should be covered with fire retardent material.

Do HUD regulations permit such alterations to the physical structure without approval?

A: HUD regulations require prior approval only for major alterations such as roof replacement. This repair to a few units would not normally require HUD approval, as the management is expected to undertake such minor maintenance and upkeep on its own. Repairs poorly made or left undone should be discovered in the annual physical inspections or management reviews.

Q4: Do you have any knowledge as to whether this potentially dangerous situation has been corrected?

A: Only one unit on the fifth floor is presently occupied. While this situation has not yet been corrected, plans have been made to make the necessary repairs as soon as weather improves. The Area Office is presently reviewing a roof repair proposal submitted by the owner. The poor insulation on the fifth floor will be improved at the time of these repairs and the code violation cleared up.

Eden Green North - Chicago

At Eden Green North, a project assigned to HUD in 1972 and serviced by the Chicago Area Office, inspection reports contain evidence of the need for immediate attention to leaking roofs dating back to 1973. However, in November 1978, a special inspection report concluded that while there were maintenance deficiencies, none required immediate attention and that the management agent was making good progress on the roof repair and replacement. Yet the Committee's Investigations result of water damage, and at least one tenant was living in an apartment with a collapsed ceiling resulting from leaking.

Q1: Does HUD consider 30 uninhabitable apartments in a 348 unit apartment complex to be normal maintenance not requiring immediate attention and good progress on roof repair?

Q2: If HUD cannot prevent such living conditions in the projects it holds, would it not be better to foreclose on the property and sell it with the condition that the new owners make the repairs, with HUD providing any rent subsidies necessitated by the repairs?

Q3: Despite the 6-year problem of leaking roofs on this project the delinquency exceeds $1 million. How can HUD justify not foreclosing on such a project or making it fit for human habitation?

A: We agree that the living conditions at Eden Green North are not yet satisfactory despite efforts to improve them. The Department's policy on foreclosure is that it should be used only when other tools available to save a project have been exhausted or will not solve the project's problems. In this case, we followed that approach, and after other attempts to solve this project's problems failed, the project was recommended for foreclosure.

Beech Park - Fairfax, Virginia

Q1: I understand that the Beech Park project in Fairfax, Virginia was abandoned by the builder in 1974 with the project only 70 percent completed, and that no units in the project were ever rented.

Is that correct?

A: It is true that construction officially halted in 1974, but the mortgagor continued to seek additional financing for completion. It is true that no units in the project were ever rented.

Q2: Is it also correct that the Virginia Housing Development Authority and the Fairfax County Redevelopment and Housing Authority have been negotiating with HUD since November 1975 to purchase the project?

A: The Virginia Housing Development Agency began negotiating to have the mortgage assigned to them in 1975. However, the Fairfax County Housing and Redevelopment Authority only began to negotiate its purchase of the property in 1977 after HUD acquired the property.

Q3: I understand that a sales price of $3.9 million was originally proposed in 1977 but after three of the nine buildings in the project were demolished in 1978 due to vandalism and exposure to the elements, HUD has revised the sales price downward to $1,722,268. Is that correct?

A: The sales price of Beech Park was determined by appraising its "residual" value. This is determined, first, by calculating a market value sustainable by estimated project income and assuming rehabilitated project condition. The projected rehabilitation costs are then subtracted from this value. The residual "as-is" value is established as the sales price.

The residual value for Beech Park was calculated at 3.9 million dollars when it was assumed that the project would remain 300 one, two and three bedroom units. However, citizens in Fairfax County including nearby condominium owners and members of the Board of Supervisors were concerned that the project's density was excessive for the character of the surrounding community and would create numerous planning problems including congested roads and schools.

In addition, the Area Office noted "there is a strong need in Fairfax County for assisted housing for those very large families least able to find shelter in the conventional market."

These concerns were combined in a proposal by the County to lower project density by demolishing some highly deteriorated units and combining others to create larger units for large and very large families. A County Architectural and Engineering study revealed that the increase in development cost and decrease in total units based on this proposal would lower the project's residual value to $1,638,320. HUD approved the sale based on these terms prior to the actual demolition of the units.

Q4: Why has HUD been so slow in completing this sale?

A: This project was not owned by HUD during the entire time that the Virginia Housing Development Authority expressed interest in taking over financing for the project. HUD did not foreclose on the project until 1977. Central Office approved the negotiated sale only seven months after the project was foreclosed upon. Subsequently, however, the Fairfax County Housing and Redevelopment Agency requested a revision of the terms of sale to enable them to lower the density of the project. The sale was completed fairly quickly considering the delays caused by this request for revision, the time taken by the purchasers to develop their complex rehabilitation plans and the normal negotiation process.

In the period between construction stoppage and foreclosure, the Department attempted without success to find a suitable alternative for project completion short of foreclosure. First, the Area Office unsuccessfully negotiated between the mortgagor, contractor, and subcontractors towards work resumption. Second, the Department attempted to arrange a reassignment of the mortgage to the Virginia Housing Development Authority which would have enabled the release of more funds for construction. However, the parties were unable to agree on the terms for such a reassignment. Subsequently, the Department foreclosed upon the mortgage.

348

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# NONDEPARTMENTAL WITNESS

## STATEMENT OF JAMES C. STURDEVANT, DIRECTOR OF LITIGATION, SAN FERNANDO VALLEY NEIGHBORHOOD LEGAL SERVICES, INC.

### PREPARED STATEMENT

Senator Proxmire. We have one final witness this morning, Mr. James C. Sturdevant, a legal services attorney with San Fernando Valley Neighborhood Legal Services, Inc., in Pacoima, Calif.

Mr. Sturdevant, since we did not receive an advance copy of your prepared testimony, I have not had an opportunity to go over your remarks. However, the hour is late so if you could summarize your statement, we will print the full text in the record.

[The statement follows:]

## STATEMENT OF JAMES C. STURDEVANT, DIRECTOR OF LITIGATION, SAN FERNANDO VALLEY NEIGHBORHOOD LEGAL SERVICES

### INTRODUCTION

Mr. Chairman,and Members of the Senate Appropriations Subcommittee on HUD-Independent Agencies:

The following is testimony I wish to give to your Subcommittee regarding my experience with HUD's mismanagement of its multifamily housing programs, particularly the Section 221(d)(3) and Section 236 programs. Before describing the specific examples I have witnessed of HUD's inability to effectively monitor and manage these multifamily housing programs designed by Congress for low and moderate income people, I would like to briefly state my experience in this regard for the Subcommittee.

Since graduation from law school in 1972, I have been engaged in legal practice on behalf of low-income individuals for a number of federally funded legal services programs in this country. From September, 1972 through May,1978, I worked as a Legal Services lawyer in programs in the State of Connecticut. Since October, 1978 I have been employed as the Director of Litigation for San Fernando Valley Neighborhood Legal Services in the Los Angeles area. Since October, 1975 I have primarily specialized in the area of housing, particularly the impact of HUD's administration of federal housing programs on low-income clients whom I represent. Attached to my testimony as Exhibit A is a copy of my letter addressed to Thomas van der Voort dated January 8, 1980 concerning my appearance before the Subcommittee, which relates my experience in federal housing litigation.

At the present time I am primarily involved in two principal cases challenging HUD's failings in the administration of the Section 221(d)(3) and Section 236 housing programs. First, I am a member of the Committee of Counsel which is overseeing the distribution of a $60 million fund -- to be returned to tenants in settlement of the 1974 Tax and Utility

Subsidy Litigation brought to compel HUD to implement that subsidy program nationwide on behalf of low-income tenants residing in Section 236 projects. I was and remain lead counsel on behalf of the statewide class of Connecticut tenants certified in Dubose v. Harris. In addition, I am supervising the conduct of the litigation brought by low-income tenants statewide in California against the Secretary of HUD in January, 1979 regarding HUD's failure and refusal to recalculate rental charges imposed on those tenants by taking into account tax savings resulting from Proposition 13 which became effective on July 1, 1978. My participation in those two lawsuits and my intimate involvement with HUD in the lengthy process of settlement of the Tax and Utility Subsidy Litigation has lead me to conclude that there are serious shortcomings in HUD's management and oversight of these two multifamily housing programs.

Some of the information I am providing to the Committee today has never before been made public. It is information I have learned during years of intensive litigation against HUD in cases which have given me an intimate understanding of the general operation of the agency. It is information which you must have if this Subcommittee is to be able to formulate appropriate and enforceable remedies to compel HUD to comply with both the letter and spirit of the law.

In my testimony, I will concentrate on four major areas:

1. HUD cannot effeciently oversee the operation of projects under its control because it does not even know the number and location of these projects;

2. HUD fails to ensure compliance with its directives by project owners or by HUD's field offices;

3. HUD does not effectively monitor the financial condition of projects under its control;

4. HUD regularly fails to implement subsidy programs which would help ensure the financial viability of its projects.

## I. HUD'S UNAWARENESS OF NUMBER AND LOCATION OF PROJECTS.

HUD cannot begin to carry out Congressional directives to monitor the subsidized housing projects under its jurisdiction because it is unable to determine the number of projects for which it has responsibility or the location of these projects. The Settlement Agreement in the tax and utility subsidy litigation was executed in October, 1978 by attorneys for HUD and for tenants.[1] That Agreement provides in paragraph 16 that the "HUD Central Office shall provide plaintiffs' accounting firm within a reasonable period of time with a list of every Section 236 project." That list was to include for each project:

a) project name,

b) project address of record,

c) number of rental units,

d) date project reached sustaining occupancy, and

e) the increase in tax and utility costs as of September 30, 1977 over the initial operating expense level for each project. The Agreement further specified that HUD field offices were to provide information not available to HUD Central, and the field offices were so informed on November 24, 1978 by a Memorandum from HUD Deputy Assistant Secretary Marilyn Melkonian. Field offices were instructed to submit all data required by the Settlement Agreement to plaintiffs' accounting firm, on a form designed and duplicated by the accounting firm; the deadline for submission was December 7, 1978. This instruction to the field was decided upon by HUD's Central office because HUD discovered after signing the Settlement Agreement that it had no list of Section 236 projects.

HUD field offices did submit the requested information by about January 25, 1979, but many of the forms were incompletely or inaccurately filled out. Plaintiffs' accounting firm, Price Waterhouse & Co., was therefore required to play an active role in preparing a usable project list, since the information submitted by HUD was incomplete and unreliable.

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[1] The Settlement Agreement is reproduced in its entirety in the Appendix to the opinion approving the settlement in *Dubose v. Harris,* 82 F.R.D. 582 (D. Conn. 1979).

As a result of its review of HUD's project list and of owner and tenant inquiries, Price Waterhouse & Co. learned of 211 projects throughout the country for which no information had been provided by HUD. A list of the names and addresses of those 211 projects was sent to HUD on May 8, 1979.

Some nine months after the signing of the Settlement Agreement, HUD discovered a purportedly complete list of Section 236 projects nationwide in HUD's Office of Finance and Accounting (OFA). See, Summary of Status Conference on August 2, 1979, at paragraph 4 filed in Underwood v. Landrieu, Civ. No. 79-1318 HP (C.D. Cal.). That list was mailed by HUD to plaintiffs' accounting firm on August 1, 1979.

On the OFA list were a total of 242 additional Section 236 projects whose existence had neither been previously reported by HUD nor been independently brought to the attention of plaintiffs' accounting firm. However, even that list was inaccurate. It did not include 81 projects the accounting firm had located, and it did include 51 projects which were either vacant or had never been built. Because of the inadequacy of the information supplied by HUD, nearly a year was required for Price Waterhouse & Co. employees to assemble a reasonably accurate list of the names and locations of all Section 236 projects in the country.

Unfortunately, even though that list was submitted to HUD in August, 1979, HUD has made no apparent use of it. In the litigation I am handling to compel HUD to recompute rents in California projects to take into account tax savings engendered by Proposition 13, similar problems have occurred. HUD's Court ordered review of rent schedules of Section 221(d)(3) and Section 236 projects in California to be completed by October 1, 1979, ignored 123 of the Section 236 projects within the state.

apparently because HUD's Central office had never informed the California HUD field offices about the existence of these projects.

Of course, any HUD effort to monitor the projects under its control will be incomplete and inadequate until HUD takes the necessary first step of identifying and locating those projects.

## II HUD HAS CONTINUALLY FAILED TO COMPEL COMPLIANCE BY SUBSIDIZED PROJECT OWNERS WITH HUD DIRECTIVES

### A. Gap Information Essential for Implementation of Tax and Utility Subsidy Program.

Both the 1974[2] and 1977[3] legislation required HUD to determine the initial operating expense level and the increases in real estate taxes and utilities in every Section 236 project nationwide in order to implement the Congressional tax and utility subsidy programs for low income tenants residing in these projects. HUD's failure to implement the 1974 program resulted in more than 40 lawsuits. Every federal court to consider the question held that the program was mandatory and ordered HUD to implement it.[4] The 1977 amendments made clear that the 1974 program was mandatory and the legislative history reaffirmed Congressional intent that HUD subsidize increases in the cost of real property taxes and utilities.[5]

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[2] Section 212 of Pub. L. No. 93-383, 88 Stat. 633, the Housing and Community Development Act of 1974, 12 U.S.C. §1715 z-1(f)(3) and (g).

[3] Section 206 of Pub. L. No. 95-128, 91 Stat. 1111, the Housing and Community Development Act of 1977, amending 12 U.S.C. §1715z-1(f)(3) and (g).

[4] See e.g., Dubose v. Hills, 405 F. Supp. 1277 (D. Conn. 1975), modified, 420 F. Supp. 399 (D. Conn. 1976); Underwood v. Hills, 414 F. Supp. 526 (D.D.C. 1976); Ross v. Community Services, Inc., 396 F. Supp. 278 (D. Md.) subsequent opinion, 405 F. Supp. 831 (D. Md. 1975), aff'd mem., 544 F.2d 514 (4th Cir. 1976) (per curiam); Abrams v. Hills, 415 F. Supp. 550 (C.D. Cal.), aff'd, 547 F.2d 1062 (9th Cir. 1976).

[5] See, H. R. Conf. Rep. No. 95-634, 95th Cong. 1st Sess. 62-63, rept. in 1977 U. S. Code Cong. & Admin. News 2965, 2982-84.

In part,because of this reaffirmation of Congressional intent HUD agreed to settle the 1974 litigation. Because this information was required to be in HUD's possession by the 1977 legislation, HUD agreed in paragraph 16(g) of the Settlement Agreement executed in October, 1978, to provide plaintiffs' accounting firm with "the increase in tax and utility costs as of September 30, 1977, over the initial operating expense level for the project" (the "Gap").

To implement the tax and utility subsidy provision of the 1977 Act HUD Assistant Secretary Simons, by HUD Notice H 78-14 dated February 23, 1978, required the managers of all HUD field offices to establish an initial operating expense level and to determine the amount by which the cost of property taxes and utilities had increased (the "Gap") for all Section 236 projects under their jurisdiction by April 10, 1978. This was to be accomplished by having each field office send a notice to every project owner requiring the submission of necessary information by March 31, 1978. Field offices were required to submit the data collected from project owners to HUD Central not later than April 20, 1978. See, HUD Notice H 78-32 dated March 31, 1978.

Both the initial and increased cost levels were essential for HUD to know so that it could calculate payments under the 1977 subsidy program. Moreover, because HUD claimed it had obtained this information from each Section 236 project owner in order to implement the 1977 Act, HUD insisted that the $60 million tax and utility subsidy settlement under the 1974 Act include a provision requiring individualized payments to all claimants of the precise amount that taxes and utilities had increased in each Section 236 project. As stated above, it was HUD's obligation to provide that information to plaintiffs' accounting firm under paragraph 16(g) of the Settlement Agreement executed in October, 1978.

However, in July, 1979 while Price Waterhouse & Co. employees were consolidating all information provided by HUD into a single computerized list, they realized that GAP data were missing for 1,469 Section 236 projects or approximately 25% of all such projects in the country. When the accounting firm raised the issue with HUD, HUD's explanation was that the missing data was due to nonresponse by some project owners to HUD's request for GAP data. HUD's response to plaintiffs' counsel was that this "nonresponse" occurred because there was no financial incentive for the project owners to comply with the HUD Notice.

As a result of HUD's failure to take any action to compel project owners to submit information upon demand, the costs of the distribution of the $60 million settlement fund have been unnecessarily increased and the implementation of the tax and utility subsidy program under the 1977 act took place in total disregard of the needs of tenants in a full quarter of all projects nationwide.[6] And, in addition, some project owners nationwide learned what other owners had already discerned -- that HUD's directives and requirements could be ignored and no sanctions or discipline would be imposed, as contemplated by the Regulatory Agreements.

### II. B. HUD's Failure to Obtain Annual Financial Information From Project Owners.

In *Frakes v. Harris*, the named plaintiff tenants who reside in four Section 221(d)(3) and Section 236 projects in California sued the Secretary of HUD in January, 1979, to compel her to immediately recalculate the rental charges in all such projects statewide based upon the substantial tax savings realized from the passage of Proposition 13 in June, 1978. Based upon the Congressional purposes of these housing programs, the federal district court preliminarily emphasized that tenants were entitled to a reasonably immediate recalculation of rental charges for July 1, 1978 forward in which 1978 tax savings are balanced against necessary 1978 project expenses. (A copy of the Memorandum and Order is attached as Exhibit B). Prior to recalculating rental charges HUD must obtain current annualized financial information from each project owner or manager.

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[6] In *Taylor v. Harris*, 452 F. Supp. 88 (D. Conn. 1978), the district court denied preliminary injunctive relief to compel the Secretary of HUD to implement the revised 1977 tax and utility program finding that the Secretary was "endeavoring in good faith" to implement it in a "reasonable manner"based on a lack of sufficient funds. However, the ranking of Section 236 projects and tenants to assure the payment of this subsidy to those most in need in accordance with the Affidavit of Marilyn Melkonian filed with the Court was skewed based upon the lack of critical information obtained from 25% of all projects nationwide. 452 F. Supp., at 93-94 and n. 7, 96-97; *see also*, 24 C.F.R. §236.901, *et seq.* published in 43 Fed. Reg. 23566-69 (May 31, 1978) (interim rule for implementation of the tax and utility subsidy program).

Documents produced through discovery in the Frakes litigation indicate HUD's knowledge that many project owners have historically failed to submit annual financial reports and are in violation of several regulatory agreement provisions. Indeed for some projects no financial information has been submitted to HUD after 1972. The Regulatory Agreements [7] and HUD Handbook provisions [8] explicitly require the submission of financial statements every year by all Section 221(d)(3) and Section 236 project owners within 60 days of the end of each fiscal year. The same Handbook provision, as amended by Transmittal 33 on August [illegible], 1977, states that:

> Delay in submission of financial statements may allow time to dissipate cash to the extent that there will not be sufficient cash to make the required deposit [to the Residual Receipts Account] when a review is made by the Area/Insuring Office.

HUD's failure to enforce the Regulatory Agreement against project owners who continually fail and refuse to submit annual financial information showing project increase and expenses has had predictable consequences. In 1973, HUD projected that 20% of all Section 236 projects would fail in their first ten years. Housing in the Seventies, an October 6, 1973 publication by the Secretary of HUD, at 4-20 and 40-57. A 1975 HUD study found that foreclosure and sale of subsidized projects were steadily increasing. Between fiscal years 1968 and 1973, 10 projects were sold; in 1974-1975, 77 projects were sold; and for 1976, 609 projects were either in the process of being foreclosed upon or were estimated by HUD to be on the brink of foreclosure. "Multifamily Property Disposition," a Staff Study by the United States Department of Housing and Urban Development, October, 1975, at 1.

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[7] See e.g. Paragraph 9([illegible]) of the Regulatory Agreement for Limited Distribution Mortgagors under Section 236 of the National Housing Act.

[8] HUD Handbook 4350.1, Chap. 3, §1, at 2 para. 4a.

It is not surprising then that so many of these projects are in default or have become HUD-held over time. This consequence stems from a total lack of HUD oversight and management of HUD subsidized projects for which annual financial data are not provided. In the absence of such data, no review of project expenditures is possible; HUD will neither learn of, nor take action to end, the unauthorized or illegal dissipation of project funds.

### C HUD's Failure to Comply with Its Obligations Under the Tax and Utility Settlement to Notify Tenants

#### 1. Distribution of Preliminary Notices of Settlement.

Under paragraph 10(b) of the Settlement Agreement, HUD agreed to instruct Section 236 project owners to post and distribute to all current tenants a copy of the preliminary notice of settlement and to "require" project owners to certify compliance within 15 days to plaintiffs' accounting firm. The purpose of the preliminary notice was to advise tenants of their possible membership in the nationwide class and the place and date of the final hearing to consider the reasonableness of the settlement terms.

By memorandum dated January 25, 1979, HUD Assistant

Secretary Lawrence B. Simons instructed each Section 236 owner or manager to distribute preliminary notices of the settlement to his tenants (and provide forwarding addresses and certify compliance within 15 days), as required by order of the Federal District Court in Washington, D.C., in *Underwood vs. Harris*, the nationwide case.

Six months later, in July, 1979, 902 project owners had failed to distribute those notices to their current tenants. On July 23, 1979, Mr. Simons instructed all HUD area office managers to require their employees to distribute notices in these non-complying projects by September 7, 1979. At two status conferences held with the Judge supervising the distribution during August, 1979, HUD's lawyers represented to the Court that HUD personnel were proceeding satisfactorily with distributing notices and would meet the September 7th deadline. Yet at a September 12 status conference, HUD reported 120 projects for which HUD personnel had failed to post notices. By September 23, 1979 there were still 74 non-complying projects and by October 5 49 remained outstanding.

After more than eight months, HUD still had not completed the job. Tenants who moved away from the projects during that time were not informed of their entitlement to recover for rent overcharges they had been forced to pay. And, again, project owners and HUD field office personnel were allowed to simply ignore the directives of HUD's Central Office.

### 2. Distribution of Claim Forms to Tenants

Paragraph 11 of the Settlement Agreement provides that Section 236 project owners or managers are required to display posters and distribute claim forms, and that HUD shall require them to certify compliance in writing to plaintiffs' accounting firm. Upon being advised by the accounting firm of the non-receipt of the required certification the Settlement Agreement provides that HUD shall promptly distribute claim forms to all tenants in the non-complying projects. The Agreement further specifies that tenants shall have 60 days to fill out claim forms. Since the deadline for filing was established, with HUD's concurrence, as January 31, 1980, all claim forms should have been in the tenants' hands by November 30, 1979.

The claim forms were mailed by plaintiffs' accounting firm to the owners/managers of all 4,300 Section 236 projects during the week of October 22, 1979. HUD Assistant Secretary Simons instructed all of HUD's field offices by letter of October 25, 1979, that owners must be contacted and instructed to distribute claim forms, and for any owners who did not comply, the area offices would be required to do so by November 30, 1979. Roughly half of the owners complied. by November 19, 1979, Price Waterhouse & Co. sent to HUD's Central Office and to each HUD area office a list of all of the 2,100 projects under the jurisdiction of that office for which HUD was obliged to distribute claim forms. Again, compliance was tardy. Tenants in several hundred projects did not receive claim forms until late December. By January 18, 13 days before the deadline, there were still 21 projects for which certifications of compliance had not been received.

My conclusion, based on these experiences, is that HUD simply has no effective mechanism for making either project owners or its field offices carry out direct orders from the Central Office.

## III. HUD FAILS TO EFFECTIVELY MONITOR THE FINANCIAL CONDITION OF PROJECTS.

### A. Identity of Interest and Unauthorized Distributions.

HUD has no policy regulating "identity of interest," a practice by which owners or managers of such projects contract with organzations which they themselves own to perform maintenance or gardening services at the project, or to purchase supplies or other goods. Without effective controls, these operating expenses can be inflated and profits can be skimmed from the projects through the management's use of identity of interest firms. Moreover, there is a strong likelihood that such abuses occur in large numbers of subsidized projects.

On September 27, 1978, the HUD Office of the Inspector General issued an Audit Report regarding identity of interest problems in HUD Region IX (attached hereto as Exhibit C). The purpose of the audit was to determine:

> . . . how extensively management agents and project managers used related firms. . . to provide goods and services for the project, and whether (a) procurements from related companies were advantageous to the projects, prices and other factors considered . . . and (c) [whether] field office monitoring of such activities was adequate.

Exhibit C, at 1.

The Inspector General found, *inter alia*, that questionable transactions had occurred in 11 of the 16 projects examined, which were managed by three managing agents. The agents' use of identity of interest firms to provide goods and services resulted in unnecessarily high and inflated project operating expenses. In those eleven projects, the audit identified "at least $67,932 in questionable charges" (Audit Report, Exhibit C, at 5). In particular, the Report disclosed four kinds of abusive practices. First, managing agents were charging the projects more than the managing agent paid to its subsidiary for repair and maintenance work. In a related scheme, agents would employ their own maintenance staff from another company to do work which was minor in nature and could have been done less expensively by a hired laborer. Second, managing agents were charging projects a markup of between 20% and 27% on materials and supplies purchased from other, self-owned, companies. Third, managing agents were found to be charging the projects for lawn maintenance work done by companies they owned at rates which were much higher than, and sometimes double, what the work actually cost. Fourth, costs of painting, laundry concessions, and carpet shampooing done by related companies were billed to the projects by their owners -- the managing agent -- at higher than the actual cost of those services.

The Report concluded that these transactions occur mainly because "HUD has not established guidelines regarding the monitoring by field offices of [managing agents] using identity of interest. . . in the management of HUD insured multifamily projects." (Audit Report, at 4).

Since HUD has no guidelines to control them, there is every reason to believe that similar abusive practices are widespread.[9] Indeed, discovery obtained in the Frakes litigation demonstrates that in three of the four named projects therein, defendant project owners made questionable transactions involving identity of interest firms.

In one named project, an unauthorized dividend was paid to the partners when the project was not in a surplus cash position according to the accountants' notes to financial statements.

The annual audit of the project disclosed that the management company purchased $14,628.00 worth of repairs, maintenance and appliances from an entity "related by common ownership to the management company." That management company was paid $19,000.00 in management fees in 1978 for the 64 unit project.

In a second named project during the year 1977 when the project's statement of profit and loss showed it paid management fees of $83,000.00, the general partners were also paid $26,000.00 for management.

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[9] The nature and extent of the abuses uncovered in the audit report cannot be over-emphasized. The three managing agents whose practices were reviewed in the Audit just described manage a total of 130 subsidized projects in California or more than 10% of all such projects located in the state.

In his report to the Congress, the Comptroller General, after reviewing some 40 audit reports conducted by the office of the Inspector General of HUD between July, 1972 and August, 1974, came to similar conclusions. See, Report to the Congress by the Comptroller General entitled "Section 236 Rental Housing - - An Evaluation with Lessons for the Future,"PAD-78-13, Appendix I, at 152-154 (January 10, 1978).

In a third named project the partners took an unauthorized dividend of $5,681.00 more than they were allowed under applicable HUD regulations which limit their dividends to 6%. That project also spent $28,300.00 for management services[10] in [illegible] and employed a management company which apparently allowed the resident manager to misappropriate $2,[illegible] in project funds. The accounting report disclosed that the resident manager had failed to report that amount of income and noted "it appears that there has been a lack of timely review at the management company level to ascertain the reasons for the monthly rental collections being so much lower than the approved rental schedule."

In the same project, a cash transfer of $615 was erroneously deposited into the account of another partnership under the control of the management company in March, 1978. The accountant's report is dated December 31, 1978, and was submitted to HUD. Yet plaintiffs' discovery demonstrates that as of April 5, 1979, the financial statement had not yet been analyzed, that HUD has no written policy covering how to deal with funds deposited to the manager's account, and that although HUD does have a policy of writing to owners to ask for the return of improperly taken dividends, there are no guidelines for what to do if the owners ignore the letter.

In a separate lawsuit filed in the federal court in California by two named low-income tenants residing in a Section 221(3)(3) project against the Secretary of HUD and the owners of the housing project, the issue raised was the failure of the project owners to obtain prior written approval of the imposi-

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10/ Paragraph 3 b of HUD Handbook [illegible] entitled "Compansation for Management Services in Multifamily Housing Projects with Insured or HUD-held mortgages" (eff. July, 1974), at 3, provides that the management fee is to pay for the "management agent's expertise, since he is responsible for assuring that. . . rents are properly computed and collected, and for establishing a control system for operating the project on a sound fiscal and physical basis in conformity with HUD requirements." Despite apparent non-compliance with this provision by HUD and the management agent for this project, the management fee established in California for these projects is 7-7 1/2% of "gross collections," HUD Handbook 4381.5, para. 3d, at 5, and the managing agents for almost all Section 236 projects in California receive the same percentage fee.

tion of additional charges to the tenants for the lease of air conditioners in violation of a specific HUD regulation, 24 C.F.R. §221.530(a), and also in violation of the National Housing Act which requires the imposition of rents and other charges at the lowest rate economically feasible. Discovery in the case revealed that the Regulatory Agreement between HUD and the project owners was executed on June 1, 1969. A lease for the air conditioners was executed between the owners of the housing project and the officers of the leasing corporation (all of whom were the same parties as the owners of the apartment project) on February 15, 1970. The rental of each unit was $7.50 per month. The total amount of the rental per month of all 64 air conditioners was $480.00 which discovery showed was the total amount received by the owners of the housing project as individuals from the leasing company. In April, 1971 a HUD audit team revealed the lack of any prior approval of these charges by HUD. In response to a request for documentation, HUD was furnished with a copy of the lease agreement indicating the identity of interest between the leasing company and the owners of the project and a model lease between the owners of the project and the tenants. Based solely on those documents, the $7.50 per month per unit charge was approved. Accordingly,although HUD knew of the identity of interest approximately 2 years after the Regulatory Agreement was signed, HUD made no assessment of the reasonableness of the charges which over the course of time have accumulated to some $900.00 for each of the units.

It is clear from the foregoing that owners can use project funds to make unnecessary cosmetic improvements at their projects and HUD would not monitor expenses to determine whether or not the expenses were reasonable or necessary. Owners or managers can contract with organizations which they themselves own to perform maintenance or gardening services at the project or to purchase supplies or other goods, all at highly inflated prices, and HUD would not be able to take effective action to prevent loss of project funds. In fact, HUD would not even be able to tell if owners or managers used project funds to do work on other apartment buildings or even homes which they owned since no HUD employee reviews or examines project budgets unless the owner asks for a rent increase, and since HUD has no requirement for audits of project accounts.

HUD's failure to adequately monitor these financial transactions will continue to lead to inflated operating expenses, the imposition of excessive rents and other charges on low-income tenants, and jeopardize the fiscal viability of the housing projects themselves.

B. Recertification of Tenants' Incomes

12 U.S.C. §1715z-1(g) and 24 C.F.R. [illegible] explicitly require all Section 236 project owners to recertify the income of each tenant paying less than fair market rent each year. Since 1971 HUD has been repeatedly criticized by the Comptroller General of the United States for failing to enforce the provisions against project owners and failing to ensure that eligible tenants occupy Section 236 projects and that proper rents are charged. In his most recent Report to the Congress the Comptroller General stated that HUD is not requiring payment of sufficient funds into the excess rental charge fund 11/ and that HUD has made little progress in collecting the correct rental charges from low-income tenants since HUD was informed of the problem in 1971. The Report concludes that:

> Numerous weaknesses still exist in the way Section 236 project owners carry out their income recertifications. Also, HUD has not effectively monitored income recertifications.

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11/ This fund, 12 U.S.C. §1715z-1(g), is comprised of all rent collected in excess of the basic rental charge and was the primary funding source for the tax and utility subsidy programs. See e.g. Dubose v. Hills, 405 F.Supp. 1277 (D.Conn. 1975), 320 F.Supp. 499 (D.Conn. 1976); Taylor v. Harris, 452 F. Supp. 88 (D. Conn. 1978).

> at projects to insure that they are carried out in conformance with HUD requirements and in a manner which insures that proper rents are charged tenants in the projects and excess rents are remitted to the Federal Government.[12]

There is no reason whatsoever to believe that HUD is now enforcing its own regulation against defaulting project owners dispite the repeated criticisms and the financial viability of these housing projects.

C. Refusal of Project Owners to Accept Housing Assistance Payments for Eligible Tenants Under the Section 8 Program.

In one lawsuit in Connecticut, the named plaintiff challenged on numerous grounds a substantial rental increase of $20.00 per month. As a result of the rental increase she was required to pay 76.[illegible]% of her "adjusted family income" for rent. After preliminary injunctive relief was denied she applied on behalf of herself and her minor son to participate in the Section 8 "Existing Housing" program 42 U.S.C. sec. 1437f; 24 C.F.R. §882, et seq. Although she was duly informed that she was eligible for such a subsidy certificate, she was informed by the project owner that it would refuse to enter into a contract enabling her to receive the benefits of this program. The benefits to the plaintiff and her family would have been substantial. Instead of paying $174.00 per month for rent, she would have been required to pay only 25% of her adjusted monthly income or $57.03 for rent. Under the Section 8 housing assistance contract, HUD would have been obligated to pay the remainder or $116.97 per month to the project owner, 24 C.F.R. §882.114, who is an eligible housing owner. 24 C.F.R. §882.110(c).

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[12] The Report is entitled "Little Accomplishment in Insuring that Proper Rents are Charged Under the Section 236 Rental Assistance Housing Program," CED-76-146 (October 15, 1976), at 16.

In his Report the Comptroller General also found that many tenants paid less rent than HUD should have required and accordingly that few excess rental charges were sent to the Secretary by the project owners.

"For 607 or 81 percent of the 750 tenants' records reviewed at 15 projects, recertifications were made late or not at all. [Applying an average rental increase of $3.00 per month,] GAO estimates that rents were underpaid by about $13,800.00 from the date the tenant was scheduled to be recertified to the GAO cutoff date --June 30, 1974." Id., at ii-iii.

This owner owned the largest number of housing projects in Connecticut subsidized under Section 221(d)(3) and Section 236 of the National Housing Act. This was not an isolated refusal by this mortgagor. Investigation by the State Agency administering the "Existing Housing" program revealed that the owner would refuse to enter into any Section 8 contracts to benefit its low-income tenants residing in any of its many multifamily subsidized projects in Connecticut despite the existence of substantial benefits and safeguards to both eligible tenants and the project owner.[13/] It is unconscionable that such an owner, with HUD's knowledge and acquiescence, can refuse to accept housing assistance payments which provide substantial payments directly to the owner. It is unconscionable because this action deprives the tenants of their right to housing at the lowest reasonable cost, while acceptance of the benefits under the Section 8 existing program would impose no additional burden on the subsidized owner. It is all the more inappropriate in this case when the owner claimed that without HUD approval of the rent increase, it would default on its mortgage obligation.

Because of instances such as the above the Act should be amended to expressly require subsidized project owners to accept Section 8 housing assistance payments on behalf of eligible tenants who without such assistance may be forced to leave housing designed expressly for them.

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13/ For example, if the tenant on whose behalf the housing assistance payments are made vacates the apartment, the owner is eligible to receive 80% of the contract rent for the unit for a period of 60 days provided certain conditions are met. See, 24 C.F.R. §882.105(b)

## IV HUD'S DELAY AND RESISTANCE IN IMPLEMENTING VARIOUS SUBSIDY PROGRAMS.

In addition to its failure and refusal to effectively monitor the financial condition of multi-family housing projects and to enforce its own directives Congress consistently refused to implement subsidy programs designed by Congress to assist low-income tenants and project owners. The tax and utility subsidy program is a good example.

Congress enacted the Section 236 program in 1968 "to assist families with incomes so low that they could not otherwise decently house themselves. . . ." 12 U.S.C. §1701t. Congress designed that program "[f]or the purpose of reducing rentals for lower income families." 12 U.S.C. §1715z-1(a). Under Section 236 federal subsidies are provided to private landlords to enable them to meet the housing needs of the poor through reduced rental charges. However, because HUD officials felt that the program was not operating well, in 1973 they suspended Section 236, along with several other housing programs.[14]

Congress' reaction to that suspension was a sharp and emphatic disapproval and a directive to reimplement Section 236.[15] Recognizing that there were deficiencies in the existing 236 program, Congress enacted the tax and utility provisions in 12 U.S.C. §1715z-1 (f) (3) and (4) to relieve low-income tenants and project owners of Section 236 housing from the burden of skyrocketing costs of utilities and property taxes. But the Secretary of HUD refused to pay these subsidies and has continued in her refusal despite reprimands from Congress[16] and despite unanimous judicial rulings that [illegible] unlawful. Finally, in frustration, Congress took the extraordinary step of re-enacting the operating subsidy program in Section 206,Pub. L. No. 95-128, the Housing and Community Development Act of 1977, to reconfirm its intent that the program is mandatory and to compel HUD to immediately pay operating subsidies on behalf of tenants.[17]

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[14] The Secretary's limited discretion to suspend these programs, after a thorough study had shown they were unworkable in operation and unsalvageable, was upheld. Commonwealth of Pennsylvania v. Lynn, 501 F.2d 848 (D. C. Cir. 1974).

[15] Thus began the running battle between Congress and HUD over which of them would control national housing policy. The Senate Reports which accompanied the 1974 HUD Appropriations Act expressed the Appropriation Committee's dissatisfaction with the Secretary's suspension of Section 236. See S. Rep. No. 93-1091, 93rd Cong ., 2d Sess. 6-7 (1974); S. Rep. No. 93-1056, 93rd Cong., 2d Sess. 6-7 (1974); Dubose v. Hills, 405 F. Supp. 1277, 1287-91 (D. Conn. 1975).

HUD's claims during litigation that it would prefer a different subsidy do not justify its failure to comply with explicit Congressional directives. Nevertheless, the refusal to implement this program carefully tailored by Congress to meet identified needs led to many defaults, foreclosures, and evictions of low income tenants unable to pay substantial rental increases attributable to increases in taxes and utilities.

Moreover, even when Congress agreed with HUD, substantial delays by HUD stifle implementation of its intent. In Section 201 of the Housing and Community Development Amendments of 1978,[18] Congress replaced the tax and utility operating program with an operating assistance program for troubled multi-family housing projects. Under the statute the Secretary is accorded broad discretion to accomplish the purposes of the provision, commencing on October 1, 1978.[19] Nevertheless, the HUD handbook to implement the program was not promulgated until August 31, 1979, eleven months after the program was authorized. Funding allocations to HUD's Regional Offices were made shortly thereafter. Meanwhile, problems identified by HUD regarding its multi-family housing programs go unaddressed.[20] Specific recommendations regarding the propriety of specific subsidy programs will be addressed at a later date.

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[16] *See* e.g., S. Rep. No. 94-749, 94th Cong., 2d Sess. 18 (1976); 122 Cong. Rec. S. 10775 (daily ed. June 26, 1976) (remarks of Senator Sparkman); 123 Cong. Rec. H. 4286-87 (daily ed. May 11, 1977) (remarks of Representative Hanley); 123 Cong. Rec. S. 9045-46 (daily ed. June 7, 1977) (remarks of Senator Humphrey).

[17] *See*, H. R. Conf. Rep. No. 95-634, 95th Cong., 1st Sess. 62-63, *rept. in* 1977 U. S. Code Cong. & Admin. News 2965, 2982-83.

[18] Pub. L. No. 95-557, 92 Stat. 2086, 12 U.S.C. §1715 z-1 a.

[19] *See*, 12 U.S.C. §1715 z-1 a(b).

## RECOMMENDATIONS

Based on my experience with the [illegible] documented failure of HUD to properly manage the Section 221 (d) (3) and Section 236 housing programs I recommend that this Subcommittee consider and implement the following administrative remedies:

1. Require that HUD within 90 days compile a list of all multi-family housing projects nationwide by name, number, address, field office jurisdiction, and program designation.

2. Require certification in writing to Congress by HUD within the time limits prescribed in legislation that it has complied with statutory obligations.

3. Require HUD to submit to appropriate Congressional Committees and Subcommittees procedures to enforce its directives to personnel in its field offices.

4. Require HUD to enforce the provisions of the Regulatory Agreements against non-complying multifamily project owners particularly with respect to the provision of financial information annually and recertification of tenant incomes.

5. Require HUD to propose for Congressional consideration and public comment a rule regulating "identity of interest" transactions.

6. Require that subsidized multifamily project owners accept assistance payments made on behalf of eligible low-income tenants such as payments under the Section 8 existing housing programs.

Respectfully submitted,

JAMES [illegible]. STURDEVANT

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[20] See, "Preliminary Findings from the Field Study"--Report of the HUD Task Force on Multifamily Property Utilization (March,1978).

Senator PROXMIRE. Go right ahead, sir. As with the other witnesses, we would appreciate it if you would confine your remarks to 10 minutes.

Mr. STURDEVANT. Thank you, Mr. Chairman, for allowing me to appear before the subcommittee to testify regarding the issue of HUD's management of its subsidized housing projects. I have been a legal services attorney since 1972 working in both Connecticut and California.

Since the fall of 1975, my practice has specialized in the administration of Federal housing programs by HUD.

My experience in litigating lawsuits against HUD on behalf of low-income and moderate-low-income tenants residing in section 221(d)(3) and section 236 projects leads me to the conclusion that from locating and identifying the existence of these projects, monitoring their monetary and financial operations, and ordering those projects to comply with Federal directives regarding the implementation or lack thereof of mandatory congressional subsidy programs, HUD's management of its multifamily housing programs is seriously deficient.

I realize the focus of these hearings is on HUD's acquired formerly-subsidized projects. My testimony will focus principally on those projects which are not in HUD's inventory, those which are still subsidized under these two housing programs, but my testimony, I think, will conclude that the reason for the number of projects now in HUD's inventory and the number expected to go into that inventory over time are inactions by HUD at both the central office and field offices in monitoring the condition and operation of these subsidized projects.

## LACK OF KNOWLEDGE OF SUBSIDIZED HOUSING PROJECTS

Let me start with what I believe to be the most serious problem. That is that HUD does not know the name and address of every section 236 and section 221(d)(3) project in this country.

Without the knowledge of the existence of those projects, it is absolutely impossible to monitor the financial operation of those projects to see that statutory and regulatory requirements are complied with by their owners.

I am a member of a committee of council overseeing the distribution of a $60 million settlement with the Department of Housing and Urban Development.

Under the settlement agreement that was executed by the Department in October of 1978, HUD agreed to provide the plaintiff's accounting firm, within a reasonable period of time, with a list of all section 236 project by name and address, the date sustaining occupancy was reached, and the increase in taxes and utility costs for each of those projects.

The central office of HUD ordered the field offices to provide Price Waterhouse & Co., the accounting firm, with that information by December 7, 1978, realizing that it did not have a master list of that information. Most of the field offices complied by late January of 1979, but the information they provided on forms provided by the accounting firm was incomplete and inaccurate.

It found 211 section 236 projects that were not included by HUD in the list that was provided. Nine months after the execution of the settlement, HUD discovered the existence of a master list in its Office of Finance and Accounting that was not available before. That list disclosed the existence of 240 newly discovered projects that HUD field offices were unaware of. That list was still not accurate. It excluded 81 of the projects identified by the accounting firm as in existence and it included 51 section 236 projects which were never built or were vacant.

Even though that list for the section 236 program has been provided by the accounting firm to HUD, apparently the California field offices of HUD are not aware of the actual existence and location of those projects. I am supervising the litigation on behalf of low-income plaintiffs, low-income tenants in section 236 and section 221(d)(3) projects, in the State of California, seeking to compel HUD to recalculate the rental charges in each of those projects, based on the enactment in California of proposition 13, under which substantial tax savings were realized by project owners because rental charges are to be established based on net operating costs at the lowest rate economically feasible to tenants.

A substantial reduction in property taxes should cause a decrease in the rental charges which would reduce the rents.

That lawsuit was filed in January 1979. As recently as a month ago, HUD was still unable to provide the court in that case with a list, just by number, of existing section 236 projects in California. In fact, the list most recently provided to the court lacked information on 113 section 236 projects located in California alone.

### NONCOMPLIANCE AND NONENFORCEMENT OF DIRECTIVES

Let me turn to HUD's noncompliance and nonenforcement of its directives.

In 1974 and in 1977, Congress, by legislation, required HUD to implement a tax and utility subsidy program.

Senator PROXMIRE. Could you summarize your statement in the next few minutes? We have applied a 10-minute rule to our witnesses this morning. We would appreciate that.

Mr. STURDEVANT. Yes, Senator.

With respect to this gap in information regarding increased utility and tax costs, based on the reaffirmation of congressional intent in the legislation of 1977, which was part of the reason for HUD settling the 1974 litigation on the same program, HUD agreed to provide that information for each project. However, 7 months after the settlement agreement was executed, the accounting firm discovered that HUD did not have that information for over 1,400 projects nationwide, 25 percent of all section 236 projects in the country. So the 1977 program was implemented in disregard of congressional demands and that information was not provided to the accounting firm.

I have provided additional information on that issue in my written statement. I have also provided information regarding HUD's inability to enforce obligations agreed to under the settlement agreement with respect to providing preliminary notices to tenants in all section 236 projects and the distribution of claim forms.

### DISTRIBUTION OF CLAIM FORMS

The delays are indicated in my written statement. I might indicate that although 13 days are left before the deadline for submission of claim forms, more than 20 projects have still not distributed claim forms to tenants who will be eligible to share in the settlement. I also stress in my written testimony, Senator, the inability and the refusal of HUD, at the field office level at least, to annually recertify tenants' incomes, as required by statute and regulation, and HUD's inability to obtain financial information on an annual basis from project owners. Discovery in the proposition 13 litigation indicated there were many project owners who had historically failed to submit that information; many since 1972, or for 8 years.

### MANAGEMENT IMPROVEMENTS BY HUD

Senator PROXMIRE. Let me ask some questions now and then you may want to summarize your statement if we don't cover its major points in our questioning.

How long have you been a legal services attorney representing tenants?

Mr. STURDEVANT. Since 1972, Senator.

Senator PROXMIRE. I asked the first witness if she noticed any improvement in HUD's responsiveness to tenants' needs over the past 2 years. She has been in her position for 2½ years. You have had more experience than she has had. Have you seen any improvement in HUD's management of multifamily projects in the last year?

Mr. STURDEVANT. There are some improvements, as Ms. Roisman mentioned, in terms of providing to projects in HUD's inventory subsidies for tenants; in other words, subsidized rents. In terms of the management of subsidized projects, the financial monitoring, the obtaining of information, adhering to its obligations under the settlement agreement, no, I do not see any improvement in HUD's management of these projects. And I am concerned, because the trend is for these projects to be mismanaged and then become part of the growing inventory that HUD is now trying to administer.

### HUD'S FAILURE TO KEEP TRACK OF ITS INVENTORY

Senator PROXMIRE. You say the first problem is the failure of HUD to even know what their inventory is. They don't have a list. They don't have the name and address of the projects. That is nowhere available. Is that right?

Mr. STURDEVANT. That is right. HUD now has, as a result of settlement and the work of the accounting firm, a master list of section 236 projects after more than a year of effort. But given the fact it had no master list before, I doubt very much if it has a list of projects subsidized under section 221(d)(3) or perhaps even the section 202 program for the elderly and that is a concern, because that is a beginning point at which HUD can know about the projects and begin to monitor their operation.

Senator PROXMIRE. Have you discussed that at all with HUD officials?

Mr. STURDEVANT. Yes, I have, Senator. They are aware, through the litigation, of the nonexistence of those projects.

Senator PROXMIRE. Ms. Roisman very effectively pointed out to us that if you want to get any information or action from HUD, you have to go pretty high up. How high have you gone?

Mr. STURDEVANT. I do not know whether the present Secretary of HUD is aware of the situation. Assistant Secretary Simons is aware of the situation, as is former Deputy Assistant Secretary Melkonian.

Senator PROXMIRE. What is their reaction? Why don't they have an inventory of where their projects are, so that they can track their status?

Mr. STURDEVANT. They haven't made an effective response. Their response was the OFA list which they discovered after 9 months and then tried to assimilate that based on what the accounting firm has been able to do, but they have made no reasonable explanation.

Senator PROXMIRE. Then, as I understand your testimony, in the first place HUD doesn't know the names and addresses of any of their projects; and in the second place they are not enforcing their directives. Is that right?

Mr. STURDEVANT. That is correct.

Senator PROXMIRE. Are there any other serious delinquencies that are quite common?

### INCOME RECERTIFICATION

Mr. STURDEVANT. On the tenants' income recertification issue, by statute and HUD regulation, project owners are required to recertify the incomes of tenants in these projects every year. The GAO report, which was furnished to the subcommittee, indicates that it has criticized HUD since 1971 in at least five separate reports for its failure to enforce those requirements and indicates in this report that the failure is ongoing, that project owners are still not recertifying tenants' income. The impact of that is that excess rentals under the section 236 program——

Senator PROXMIRE. There are two victims of that failure—the taxpayer and the tenant.

Mr. STURDEVANT. That is correct, Senator.

Senator PROXMIRE. Perhaps the tenant suffers more than the taxpayer, but they both suffer seriously because of this.

Mr. STURDEVANT. That is correct.

Senator PROXMIRE. I want to thank you very much. We thank you for your testimony. It is very useful. I apologize for the fact that you had to wait for so long and that we were unable to give you a little more time.

Is there something you didn't have a chance to point out to us that you would like to mention?

Mr. STURDEVANT. I have made specific recommendtions for administrative corrections of some of these problems in my written statement.

I would like to comment on two issues——

Senator PROXMIRE. I want to commend you on your statement. It is quite a document.

Mr. STURDEVANT. Thank you, Senator.

### PARTICIPATION OF TENANTS

First, on the issue of participation of tenants, my experience over the course of the years is that tenants are allowed to comment on the barebones of financial information the project owners submit. Project owners are then required to respond to the comments tenants submit. That is all forwarded to HUD. But HUD at no time is required to deal with tenants' comments or to base its decision on the record and identify why it made a decision with respect to a rent increase.

### "FALZARANO" DECISION

Second, with respect to the *Falzarano* decision, which you quoted earlier in the hearings today, there are two judicial circuits in this country which do not agree with the first circuit; namely, the ninth circuit in California and the District of Columbia circuit. HUD is now arguing, for example, in the proposition 13 case, that HUD's decision as to how to implement the proposition 13 program is not subject to judicial review, that Congress has entrusted rent determinations with respect to operating costs to be the exclusive domain of HUD and it alone is responsible for determining compliance by project owners with statutory directives.

The record in that case does not indicate that HUD is able to do that, I think, in accordance with congressional demands.

Senator PROXMIRE. I am not sure that is a correct interpretation of the law, as you said. I want to thank you very much.

Senator Weicker is a member of the subcommittee, also. Would you like to ask any questions, Senator?

Senator WEICKER. No questions.

Senator PROXMIRE. Thank you.

Thank you very, very much, Mr. Sturdevant, for your most useful testimony. You made a fine presentation.

### CONCLUSION OF HEARINGS

[Whereupon, at 12:48 p.m. Wednesday, January 23, the hearings were concluded and the subcommittee was recessed to reconvene at the call of the Chair.]

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# LIST OF WITNESSES, COMMUNICATIONS, AND PREPARED STATEMENTS

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Page

Blackwell, George, past president, Clifton Terrace Tenants Association ..... 3

Cohen, Marilyn, National Housing Law Project ..... 204

Cronin, John J., General Accounting Office ..... 239

Cunningham, Lynn, Clifton Terrace Tenants Association ..... 3

Dempsey, Charles, Inspector General, Department of Housing and Urban Development ..... 63

Eschwege, Henry, Director, Community and Economic Development Division, General Accounting Office ..... 15

Fultz, Keith, Audit Supervisor, General Accounting Office ..... 15

Harris, Hon. Patricia, former Secretary of Department of Housing and Urban Development:
  Letter from ..... 48
  Prepared statement of ..... 49

Jackson, Gussie, Clifton Terrace Tenants Association ..... 3

Jacquet, Eugene, Clifton Terrace Tenants Association ..... 3

Jones, Dick, Clifton Terrace Tenants Association ..... 3

Landrieu, Hon. Moon, Secretary, Department of Housing and Urban Development ..... 63

Lindsey, Linda, president, FHA Tenants United ..... 157

Maffin, Robert S., executive director, National Association of Housing and Redevelopment Officials ..... 136

Mathias, Hon. Charles McC., Jr., U.S. Senator from Maryland, prepared statement ..... 134

Medina, William A., Assistant Secretary for Administration, Department of Housing and Urban Development ..... 277
  Prepared statement ..... 293

Melkonian, Marilyn, Deputy Assistant Secretary for Multifamily Programs, Department of Housing and Urban Development ..... 63

Pfaender, Fred W., Director, Office of Single Family House, Department of Housing and Urban Development ..... 29

Roisman, Florence W., Washington office, National Housing Law Project ..... 204
  Prepared statement ..... 205

Scantlebury, D. L., Director, Financial and General Management Studies Division, General Accounting Office ..... 239
  Prepared statement ..... 240

Simons, Lawrence B., Assistant Secretary for Housing, Department of Housing and Urban Development ..... 63, 277
  Letter from ..... 296
  Prepared statement ..... 278

Sturdevant, James C., director of litigation, San Fernando Valley Neighborhood Legal Services, Inc ..... 349
  Prepared statement ..... 350

Taylor, Susan, FHA Tenants United ..... 157
  Prepared statement ..... 165

Weisbach, Samuel C., former HUD loan specialist (retired), Office of Loan Management 33
Woods, Richard, Housing and Community Development, General Accounting Office 15

# SUBJECT INDEX

## DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Page
Administrative record:
  Action to establish clear ... 99
  Need to create clear ... 122
Area office:
  Fails to resolve problems ... 118
  Seeks direction ... 98
Audit, recommendation of ... 30
Carol Management projects ... 310
Central office, reorganization of ... 90
Continues to work with owner ... 127
Clifton Terrace:
  Jurisdiction of ... 29
  Negotiated sale of ... 93
  1977 audit of ... 114
Conditions of sale, lack of specificity in ... 95
Defaulted and HUD-held mortgages ... 114
Delano Village ... 308
Disbursements ... 104
Diversion of funds ... 312
Equity requirements for purchase ... 113
FHA Tenants United allegations ... 314
  510 West Belmont ... 316
  Hil'Crest Apartments ... 318
Field staff attitudes ... 326
Flexible subsidy program ... 90
Foreclosure:
  Delay prior to initiating ... 121
  HUD initiates ... 100
  Need for legislative relief regarding ... 322
  Need to expedite ... 123
  Recommendation ... 96
  Tax losses during ... 323
  Withdrawal of recommendation for ... 123
General Counsel's advice ... 103
Housing programs, basic integrity of ... 64
HUD-owned inventory, improvements in ... 89
HUD's efforts to improve the management of its multifamily housing program (report) ... 69
Inspector General audit report ... 95
  Known irregularities ... 117
*Kent Farms* case ... 128
Late charges ... 325
Loan servicer's functions ... 310
Management:
  Goals, establishing and monitoring ... 90
  Timetable for reforms ... 277
Methunion Homes ... 313

Page
Missing records and the suspicion of fraud ........ 118
Monthly reports, undetected irregularities in ........ 115
Mortgage amount, insurance of ........ 112
Multifamily projects, HUD's troubled ........ 65
    1977 hearings on ........ 67
Multifamily property utilization task force ........ 67
Negotiating management, circumstances for ........ 102
100-percent mortgages, reasons for ........ 111
P.I. Properties under examination ........ 92
Policy changes:
    Recent ........ 89
    Significance of ........ 91
Policymaking process ........ 327
Present difficulties, source of ........ 66
Pride:
    Insensitivity and tenant dissatisfaction ........ 103
    Performance during trial period ........ 106
    Reputation at time of sale ........ 94
    Socially oriented activities ........ 109
Problem projects ........ 307
Professional manager, owner's failure to hire a ........ 124
Project accounts, commingling of ........ 311
Pumpkin Hill ........ 321
Purchase price, writedown of ........ 94
Rhode Island Plaza ........ 320
Spread sheet ........ 30
Stony Island Terrace ........ 319
Trial period expenditures ........ 104
Writedown of price to achieve affordability ........ 110

## GENERAL ACCOUNTING OFFICE

Carol Management financial statements ........ 269
Clifton Terrace:
    Condition of when acquired by HUD ........ 22
    HUD expenditures to rehabilitate ........ 22
    Investigation into by HUD ........ 26
    Resale of by HUD ........ 25
    Steps taken to make loan current ........ 24
Events surrounding project ........ 15
Field audits, problems revealed by ........ 17
Department of Housing and Urban Development:
    Audit ........ 16, 18
    Multifamily accounting system ........ 264
        Financial statements, monthly and annual ........ 265
        Monitoring and servicing mortgages ........ 264
        Reinstatement ........ 264
        Tax escrow account ........ 265
    New York field offices, loan servicing at ........ 267
GAO reports, prior ........ 267
HUD-held properties in trouble, other ........ 25
HUD servicers receive inadequate information ........ 266
Independent public accountants, reports from ........ 27
Inspector General:
    Activity of ........ 21
    Review by ........ 270
IRS study planned ........ 273
Laundry income, fluctuations in ........ 20
Managing agents, accounting records of ........ 268
Mortgage delinquencies ........ 17

Page

- New York projects, 268
  - Tax status of, 266
- 100-percent mortgage, 23
- P.I. Properties, Inc:
  - Activities during management period, 16
  - Problems during management, 16
- Pride Environmental Services, loan to, 19
- Review by GAO task force on fraud and abuse, 20
- San Francisco area office—Receipt of payments, 271
- Tax consequences, 272
- Workout agreement, 271

## NONDEPARTMENTAL WITNESSES

- Clifton Terrace Tenants Association, 3
  - Barry/P.I. Properties, Inc.:
    - Achievements of, 8
    - Condition of project after takeover by, 7
    - Effects of management, 4
    - Removal of appliances by, 9
  - FHA commitment to residents, 7
  - Fire extinguishers, 13
  - HUD foreclosure, 5
  - Rent increase request, 10
  - Roof leaks, 12
  - Security personnel, 13
  - Tenant:
    - Control, 4
    - Control of children, 13
    - Negotiations with Jones, Wells & Associates, 11
    - Priorities, 6
  - Vacant apartments, control of, 14
- FHA Tenants United, 157
  - 510 West Belmont Apartments, 159
  - 533 West Barry Apartments, 160
  - 810 West Grace Apartments, 158, 162, 163
  - 4550 North Clarendon Apartments, 158, 164
  - Hil'Crest Apartments, 159, 162
  - Low- and moderate-income housing, 160
- National Housing Law Project, 204
  - Complaints against HUD and OMB, 233
  - Decisionmaking, 237
  - Department of Housing and Urban Development:
    - Actions by, 238
    - Administration of units by, 232
    - Career personnel at, 232
    - Policies of, 233
  - Garfield Hill and Bass Circle projects, 234, 236
  - General Counsel's staff, 238
  - Judicial review, rights of, 234
  - Riverview Apartments, 234, 236
  - Robinhood Apartments, 234
  - Subsidy program, long-term, 235
- San Fernando Valley Neighborhood Legal Services, Inc, 349
  - Directives, noncompliance and nonenforcement of, 372
  - Distribution of claim forms, 373
  - *Falzarano* decision, 375
  - Income recertification, 374
  - Inventory, HUD's failure to keep track of, 373
  - Subsidized housing projects, lack of knowledge of, 371

Page

- Weisbach, Samuel C., former HUD loan specialist (retired), Office of Loan Management ..... 33
  - Auditors usually too tough ..... 37
  - Foreclosure recommendation ..... 34
    - Would have aided tenants ..... 40
  - HUD Inspector General audit of Clifton Terrace books ..... 33
    - Disappointing report ..... 36
  - Involvement in case terminated ..... 39
  - Memo urges prompt audit ..... 35
  - Negotiated sale ..... 35
  - P.I.'s monthly accounting reports ..... 38
  - Renewed negotiations ..... 39

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